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IN THE

Supreme Court of the United States

October Term, 1949

No. 728

UNITED STATES, Petitioner,

v.

UNITED STATES OF AMERICA, Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No.

UNION BLEACHERY, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petition of Union Bleachery respectfully prays for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit to review a judgment of that court entered in this case on August 3, 1949 and upon which a petition for rehearing was denied on November 18, 1949. On November 25, 1949 the mandate was issued.

Jurisdiction.

This Court has jurisdiction of this action by virtue of the provisions of Section 240 (a) of the Act of February 13, 1925 (43 Stat. 936), Sec. 240 (a) of the Judicial Code, as amended, Title 28, U. S. C., Sec. 1254; and Rule 38 of this Court.

Statutes particularly to be construed are: the Revenue Acts of 1921 (c. 136, 42 Stat. 227), 1924 (c. 234, 43 Stat. 253), 1926 (c. 27, 44 Stat. 9), and 1928 (c. 852, 45 Stat. 791), sections of which are found in the Appendix, *infra*.

The Fifth and Fourteenth Amendments to the Constitution of the United States is also involved as the petitioner's property has been taken and held for public use without due process of law and just compensation.

Specifications of Errors to be Urged.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

1. In deciding that, on June 30, 1922, the predecessor did not sell its property to this petitioner; that, instead, the property was exchanged pursuant to a plan of reorganization; that the decisions, in the former actions 70 F. (2d) 549 and 97 F. (2d) 226, holding that the petitioner acquired the property through a sale by the predecessor in not controlling in this action; and that, because of the decisions in the former actions, and the application of the theory of res judicata, the court is barred, in this action, from giving any consideration to the petitioner's claims for additional allowances as deductions for all costs for repairs and depreciation computed on the basis of the fair market value of the property as of either June 30, 1922, or March 1, 1913.

2. In failing to explain why it had decided in the former action that the predecessor sold the property to the petitioner, thereby defeating the petitioner's claim in that action; why, when holding that former decisions are controlling in this action, it specifically exempted the decision that the predecessor sold its property to this petitioner; and why it decided, in this action, in direct contradiction to its former decision, that the property was not sold but was exchanged pursuant to a plan of reorganization to the de-

feat of the petitioner's claim in this action, thus defeating the petitioners claims in both actions on the basis of decisions diametrically opposed with respect to the same transaction.

3. In deciding that, because of the facts relating to the exchange of the property and the law with respect thereto, the predecessor and the petitioner is the same taxpayer, the petitioner stands in the shoes of its predecessor and is not entitled to allowances for repairs and depreciation computed on any other basis or in any other manner than was allowed to the predecessor, right or wrong; and, in failing to decide that, under the provisions of section 202 of the Revenue Act of 1921, the separate entities of the petitioner and predecessor corporations are recognized, the sale of the property is considered as having been negotiated at arms length, and, recognition of gain or loss, if any, is not barred as between the said corporations, and that the section bars recognition of gain and loss only as between individuals.

4. In deciding that, for the purpose of this action, the transaction, whereby the property changed hands on June 30, 1922, must be construed under the provisions of sections 203, and 204 of the Revenue Act of 1924 and similar provisions of the later revenue acts instead of under the provisions of section 202 of the Revenue Act of 1921 which was in force when the transaction occurred, its decision being in conflict in both result and theory with the decision of this Court in the case of Reo Motors Inc. v. Commissioner, 338 U. S. 442.

5. In deciding that, for 1928 and all prior years, the Commissioner correctly allowed the petitioner deductions for depreciation computed on the book record of the cost of the property as of December 31, of each preceding year respectively, less the cost of property determined to have been fully depreciated, and that the petitioner is not entitled to allowances for depreciation computed on the basis of the fair market value of the property as of either June 30, 1922 or March 1, 1913.

6. In deciding that the petitioner did not meet the burden of proof resting upon it to substantiate its claim that the fair market value of its property is greatly in excess of the book record cost, and that it is entitled to allowances for

depreciation computed on the basis of the fair market value as of the basic date.

7. In deciding that the Commissioner properly disallowed as deductions repairs costing more than $5.00.

8. In deciding that the Commissioner properly disallowed deductions claimed for the petitioner's liability to pay additional taxes to the state of South Carolina for each of the years 1926, 1927, and 1928.

9. In deciding that the Commissioner properly disallowed the petitioner's claimed deductions, for the years 1923, 1924, and 1925, in the amounts of the excess over the cost or market value, which ever is lower, of the accounts and notes receivable as of the close of each of the respective years, and that such accounts and notes receivable are not part of the petitioners inventory.

10. In failing to decide that this action for refund of money belonging to the petitioner, illegally exacted and retained by the respondent, is equitable in nature, requires equitable consideration and relief and the setting aside of defenses of a technical nature, and that the remedy provided at law has not been adequate, having not provided recovery, cessation of the Commissioner's continuous illegal exactions of excessive taxes, and having not prevented contradictory decisions of the courts in support of the Commissioners erroneous determinations and the respondent's continuous and illegal possession of the petitioner's property.

11. In deciding that the general traverse filed by the defendant—respondent in this action, complied with the requirements of law and equity in answer to the complaint, that the trial court properly granted the defendant leave, in June, 1940, to amend its general traverse and to raise new issues in its defense, and properly denied the petitioners motions, (a) to revoke that court's order that granted the defendant leave to amend its general traverse, (b) to strike the general traverse from the record, and (c) to strike the amendment to the general traverse from the record.

12. In deciding that the trial judge did not abuse his power of judicial discretion in denying the petitioner's

motion for relief, applied for under Rule 60 (b) of the Federal Rules of Civil Procedure, submitting newly discovered evidence.

13. In deciding that the trial court properly denied the petitioner's motion for summary judgment, notwithstanding that the defendant did not file an answer and offered nothing but technical defenses.

14. In deciding that any of the petitioner's claims for refund or any part thereof, for any of the years in suit, are barred by the statute of limitations.

15. In deciding that this action is barred by the statutes of limitations with respect to the original claims for refund filed for the years in suit.

16. In failing to decide that the Commissioner's determinations to reject the petitioner's claims for refund are excessive, arbitrary, contrary to the provisions of law, and without rational foundation, that any presumption of correctness of his determinations that may have originally attached thereto were destroyed, that the burden of proof has shifted from the petitioner to the Commissioner and the respondent, and that the Commissioner's determinations should be set aside and considered to be nullities.

17. In failing to grant judgment for the petitioner in the full amount prayed for in the complaint.

18. In failing to take judicial cognizance of the facts and taxable history of the petitioner and its predecessor, held by it to be the same taxpayer, and to decide that, notwithstanding the petitioner's repeated efforts to obtain refund and other relief through the remedies provided at law, the Commissioner, under guise of his authority, has continuously exacted excessive taxes from the petitioner and has illegally held the property of the taxpayer for the benefit of the respondent in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States.

Questions Involved.

In the determination of its tax liabilities, is the petitioner entitled to an adjustment of its gross income for the years 1923, 1924 and 1925 by excluding therefrom the amount, as

of the close of each of the years, respectively, in which the face value exceeds the cost or market value of its accounts and notes receivable, which ever is lower, and is it entitled to additional deductions, for each of the years 1923 to 1928, inclusive, for depreciation computed on the basis of the fair market value of the property as of either June 30, 1922 or March 1, 1913, and for costs of repairs, liabilities to the State of South Carolina, and contributions, in the amounts heretofore disallowed, and, if so, is the petitioner entitled to refund of taxes overpaid.

A Brief Statement of the Facts Involved.

The action was brought, on October 23, 1933, in District Court of the United States, Western District of South Carolina, under the provisions of Section 24 (Twentieth) of the Judicial Code, for refund of $204,538.85, taxes allegedly overpaid, for the years 1923 to 1928, inclusive. The petitioner's tax liabilities accrued, for the year 1923, under the Revenue Act of 1921; for the years 1924 and 1925, under the Revenue Act of 1924; for the years 1926 and 1927, under the Revenue Act of 1926; and for the year 1928, under the Revenue Act of 1928.

Many of the facts concerning the petitioner's claims for refund, when and for what years filed, the grounds set out therein, when and in what manner amended, various actions proposed and finally taken by the Commissioner, together with other jurisdictional facts, are set forth in the pre-trial findings of fact. (R. 53-75)

In 1903, the first bleaching and finishing plant in South Carolina, one of the first two in the south, was built by the Union Bleaching & Finishing Company, a New Jersey Corporation, hereinafter referred to as predecessor. In accordance with a conservative policy and the general custom of business concerns at that time, that corporation failed to include in its capital account and charged to expense most of the cost of its capital additions, and at the same time excessively wrote off much of the costs of additions that had been previously included in its capital account.

The Commissioner approved the revenue agent's recommendations, failing to make any determination as to either cost, book cost, depreciated book cost, fair market value, or any other value as of March 1, 1913. His allowance for depreciation as a deduction from income for any year was based on the hereinbefore described book record of cost as of December 31, of the prior year, a very small portion of the original cost.

Both the predecessor and the petitioner filed claims for refund of taxes overpaid by the predecessor for the taxable years covering the period from January 1, 1916 to June 30, 1922, details with respect to which are set forth, (R. 53-75, 297-348) most of which were rejected by the Commissioner.

The petitioner brought an action, in the District Court of the United States for the Western District of South Carolina, for refund of taxes overpaid by the predecessor, for the years 1916 to 1919, inclusive. Most of the complaint in that action was dismissed for want of jurisdiction. 15 A. F. T. R. 871 (pp. 29-50, Def. Ex. E) On appeal to the United States Court of Appeals for the Fourth Circuit, Case No. 3688, the decision of the trial court was affirmed. 79 F (2d) 549. The transcript of record on appeal in that case No. 3688 is of record in this action as Defendant's Ex. E.

As a transferee of the assets of the Union Bleaching & Finishing Company, the petitioner was notified by the Commissioner of a deficiency in tax asserted to be owing by the predecessor for the period January 1, 1920 to June 30, 1922. Accordingly, the petitioner duly filed a notice of appeal with the Board of Tax Appeals (now, Tax Court), which sustained the deficiency. On appeal to the same United States Court of Appeals for the Fourth Circuit, the determination of the Board of Tax Appeals was affirmed. 97 F. (2d) 226. The transcript of record on appeal in that case No. 4295 is of record in this action as Defendant's Ex. H.

The decision of the court is contrary in principle to the

decision rendered by this Court in the case of Reo Motors Inc. v. Comm. 338 U. S. 442.

Further facts are set forth in the record (R. 297-348) and in the brief.

Reasons Relied on for the Allowance of the Writ.

The decision herein of the United States Court of Appeals for the Fourth Circuit is in conflict, both in result and theory, with the decision of this Court, handed down on January 9, 1950, in the case of Reo Motors, Inc. v. Commissioner, 338 U. S. 442, with other decisions of this Court hereinafter cited, with plain and unambiguous provisions of the Revenue Acts involved, and with the provisions of the Fifth and Fourteenth Amendments of the Constitution of the United States.

The statute of limitations is not involved for the years 1927 and 1928 for which the petitioner should at least have judgment.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued out of, and under the seal of this honorable Court, directed to the United States Court of Appeals for the Fourth Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record, including all of the exhibits, and all proceedings in this cause to the end that the said cause may be reviewed and determined by this Court, according to law; and that your petitioner may have such other and further relief as to this Court may seem proper and in conformity with the law.

Your petitioner will ever pray.

LEONARD MARSHALL,
Attorney for petitioner.

Dated:
April 4, 1950.

PETITIONER'S BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS OF THE COURT BELOW.

The opinion of the trial court is in the record (R. 125-149). The opinions of the United States District Court is set forth in the record (R. 125-149) and the opinion of the United States Court of Appeals for the Fourth Circuit is set forth in the record. (R. 291-293)

JURISDICTION.

The statement of jurisdiction is set forth in the Petition for the Writ of Certiorari.

STATEMENT OF THE CASE.

The facts generally are set forth in the petition for Writ of Certiorari. More detailed facts are set forth in this brief.

SPECIFICATIONS OF ERRORS.

The specification of errors are set forth in the Petition for Writ of Certiorari.

ARGUMENT.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

1. In deciding that, on June 30, 1922, the predecessor did not sell its property to this petitioner; that, instead, the property was exchanged pursuant to a plan of reorganization; that the decisions, in the former actions, 79 F. (2d) 549 and 97 F. (2d) 226, holding that the petitioner acquired the property through the sale by the predecessor is not controlling in this action; and that, because of the decisions in the former actions, and the application of the theory of res Judicata, the

court is barred, in this action, from giving any consideration to the petitioner's claims for additional allowances as deductions for all costs of repairs and depreciation computed on the basis of the fair market value of the property as of either June 30, 1922, or March 1, 1913.

On June 3, 1922, this petitioner, a corporation, was organized under the laws of South Carolina. On June 30, 1922, the Union Bleaching & Finishing Co., a New Jersey corporation, hereinafter referred to as predecessor, sold all of its property and chose in action to this petitioner in exchange for the petitioner's capital stock and its assumption of all of the predecessor's liabilities. On November 25, 1922, the predecessor surrendered its charter. (R. 54) The Predecessor overpaid its taxes for 1922 and all prior taxable years.

Without the filing of any claim by or for the taxpayer, the Commissioner, on June 15 1921, wrote the predecessor that he readjusted allowances for depreciation on the basis of cost and determined deficiencies in tax for the years 1916 and 1918 of $357.96 and $641.41, respectively, and overpayments in tax for the years 1917 and 1919 of $4,252.78 and $712.23, respectively, a net overpayment for the said four years of $3,965.64, and that if the predecessor would file a claim for refund that amount would be refunded. (p. 128, Def. Ex. E) (R. 176). Thereupon, the predecessor filed that claim for refund and an unpaid tax for 1920 was credited as having been paid by the amount of the overpayment of $3,965.64.

The petitioner assuming that it had a right to claim, receive and sue for refund of taxes overpaid by the predecessor, filed claims for refund of taxes overpaid by the predecessor for each of the years 1916 to 1919, inclusive, claiming that the taxes were overpaid because the Commissioner made inadequate allowances as deductions for repairs and depreciation. For the year 1918, an additional claim was filed on the basis that, although the taxpayer was entitled

to an additional deduction for amortization of the cost of war facilities, neither a deduction was taken nor an allowance made therefor.

All claims for refund, for the years 1917 to 1919, inclusive, were filed on Treasury Department Form 843, one for each of the years, and with the exception of an additional claim, for the year 1918, based on amortization, the claims alleged with respect to depreciation that; for the year 1917, refund is based on a proper consideration of adjustment of depreciation, and adjustment of fair market value as of March 1, 1913, (p. 32, Def. Ex. E); for the year 1918, refund of $80,000.00 is based on, adjustment of depreciation and adjustment of plant value as of March 1, 1913 (p. 33, Def. Ex. E); for the year 1919, refund of $50,000.00 is based on, adjustment of depreciation, and adjustment of plant value as of March 1, 1913. (p. 37, Def. Ex. E) The claims were ambiguous, especially with respect to an adjustment of depreciation, having failed to state in what manner or on what basis such adjustment should be made.

Upon his determination that the claims did not comply with all requirements of the law and regulations and for that reason are invalid, the Commissioner rejected all of the claims for refund, except the additional claim for the year 1918 based on amortization of $76,468.57, the cost of war facilities. With respect to the claim for amortization, the Commissioner determined the tax to have been overpaid in the amount of $5,840.23 on the basis of his determination that a loss of $7,674.85 was sustained through the discard and sale, prior to June 30, 1922, of war facilities costing $12,128.66, and he rejected the balance of that claim on the basis of his determination that, on June 30, 1922, the predecessor sold all of its property, including the remaining war facilities costing $64,339.81, to this petitioner in exchange for the petitioner's capital stock without apparent loss. (R. 165, 166, 201)

On December 23, 1929, (p. 2, Def. Ex. E) more than seven years after the predecessor sold its property and

surrendered its charter, an action, hereinafter referred to as "former action", was brought in the district court by this petitioner against this respondent for refund of taxes overpaid by the predecessor for the years 1916 to 1919, inclusive, years that preceded the petitioners existance. At the time that action was brought the petitioner was protesting the inadequate overpayment determined by the Commissioner for amortization and, therefore, refund of the overpayment had not been made. Based on the fact that the claims for refund, with respect to which that action was brought, with the exception of the claim for amortization for the year 1918, did not advise the Commissioner of the facts on the basis of which the taxes were alleged to have been overpaid, the defendant, the respondent in this action, alleged as an affirmative defense in its answer:

> "That plaintiff has not complied with all conditions precedent to suit in this—that claims for refund have not been filed * * * according to the provisions of the law in that regard, and the Regulations * * * that plaintiff's action, if any cause of action existed, is barred; that the claims for refund of taxes paid for the year 1919 were rejected more than two years before this action was commenced; that plaintiff's said cause or causes of action are barred under the provisions of Section 3226 of the Revised Statutes as amended." (p. 28, Def. Ex. E)

Article 1036 of Regulations 62, promulgated by the Commissioner under authority of the Revenue Act of 1921, and other regulations promulgated under authority of other revenue acts, provides:

> "Claims by the taxpayer for the refunding of taxes * * * shall be made on Form 843. In this case the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. * * *"

Under 3226 of the Revised Statutes in force when that suit was commenced, it is provided that:

> "No suit * * * shall be maintained in any court for the recovery of any * * * tax * * * claimed to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed * * * according to the provisions of law * * * and regulations * * * unless, such suit is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates * * *"

Except with respect to the claim for refund, for the year 1918, based on amortization, the court, in that former action, dismissed the complaint for want of jurisdiction on the basis of its determination, that, with the exception for amortization, the claims failed to meet the requirements of law and the regulations, were invalid and barred by the statute of limitations and did not confer jurisdiction on the court, and that the claim for refund for 1919 had been rejected more than two years prior to the beginning of that action. Upon the acquiescence of the defendant—respondent, that court ordered judgment for the petitioner for $5,840.23 upon its decision that the Commissioner properly allowed an overpayment in that amount based on the claim for amortization, and that the Commissioner properly rejected that claim for any greater amount for the reason that, on June 30, 1922, the predecessor sold all of its property, including the unamortized war facilities, to this petitioner in exchange for its capital stock without apparent loss. (R. 165-167)

In that former action, no other decision was made than is contained in the Findings of Fact and Conclusions of Law, prepared by the respondent and signed by the judge, (pp. 29-45, Def. Ex. E) of which Conclusion of Law (1) is as follows:

> "Plaintiff has not complied with all the conditions precedent to suit and, therefore, is not entitled to maintain this action except to the extent of the claim for an additional deduction from gross income for the year 1918 on account of amortization * * * and its claim for an additional deduction * * * for the year 1919 on account of depreciation" * * * (R. 167)

The court, in this action, erred in deciding that, in the former action, a decision was made on the merits of a claim for refund, for the year 1919, on acount of depreciation, and, that because thereof, the petitioner is not entitled to maintain this action on its claim of being entitled to allowances for deductions for all costs of repairs and for depreciation computed on the basis of the fair market value of the property as of the basic date.

Considering that the claim for refund of $50,000.00, for the year 1919, is alike in form and substance with the other claims for refund for the other years in suit and did not comply with the provisions of law and the regulations more nearly than did the other claims that were held to be invalid for failure to advise the Commissioner of the facts upon which the taxes were alleged to have been overpaid, it would have been impossible for that court to have made a determination on its merits and to have determined that the petitioner was not entitled to allowances for depreciation computed on the basis of the fair market value of the property as of March 1, 1913, since the Commissioner determined, the respondent urged and that court held that the claim did not set forth such or any other basis. In addition to being invalid under the provisions of Art. 1036, supra, and failing to bestow jurisdiction on that court, the claim for the year 1919 was also alleged by the respondent and admitted by the plaintiff to have been rejected more than two years prior to the bringing of that former action, and therefore that court would have been less likely to have made a determination on the merits of the claim for the year 1919 than for the claims for the other years in suit.

As shown in the Commissioners letter of June 15, 1921, (R. 176) the claim for refund of $712.23, for the year 1919, was initiated by the Commissioner. As the taxpayer immediately complied with the Commissioners suggestions, that claim was allowed, ceased to be a claim, and became an account settled in June, 1921, more than eight years before that action began. The petitioner did not complain of the

overpayment of $712.23 determined for the year 1919 and did not put it in issue. The overpayments and deficiencies in tax, for the years 1916 to 1919, inclusive, as set forth in the Commissioner's letter of June 15, 1921, *supra,* were alleged by the petitioner only for the purpose of providing the necessary data concerning the last previous determination of the tax liability, for each of those years, in order that the amount of refund could be computed if that court granted any additional deductions. Even had the petitioner complained of the refund of $712.23, the court would not have had jurisdiction of it.

Although the defendant had urged that the plaintiff was not entitled to any allowance for either depreciation or amortization and any refund based thereon, it found, during the trial, that it was not prepared to show that the Commissioner, its own agent, had erred in determining that the petitioner was entitled to refund of $5,840.23, tax overpaid for 1918, on the basis of an allowance for amortization, which determination in the absence of fraud or mistake is an award all sufficient for the foundation of a judgment. (*Woolner* v. *U. S.,* 13 Ct. Cls. 355; *U. S.* v. *Factors & Finance,* 288 U. S. 89) Therefore the defendant conceded that the Commissioner properly determined an overpayment of $5,840.23, for the year 1918, on account of amortization. (R. 166) Being charged with the duty of preparing a conclusion that the Commissioner's determinations were correct and knowing that the Commissioner had allowed overpayments for both the years 1918 and 1919, in the respective amounts of $5,840.23 and $712.23, it appears that through inadvertence a statement of the allowance for 1919 was included therein as having been correctly made. The decision, in this action, urged by the defendant, that the court, in that former action made a determination on the merits of the claim, for the year 1919, is based on the ambiguity contained in the Conclusion prepared by this respondent and adopted by the court in that former action. There were two claims for refund, for the year 1919, on

account of depreciation, one for $712.23 and the other for $50,000.00, the disallowance of the latter having been complained of in the complaint, whereas the claim for $712.23 having been allowed and refunded, was not complained of.

However, with the exception of showing that the court clearly did not make any determination, in that former action with respect to the merits of claims for refund based on depreciation upon which that action was based, it makes no difference as to which of the claims for refund for the year 1919 was referred to in the conclusions and/or decision, in the former action, as that court did not have jurisdiction with respect to either of them.

It is well settled law that a decision of a court with respect to the merits of a matter of which it is without jurisdiction is a nullity (*U. S.* v. *Anderson,* 60 F. Supp. 649), that, when in want of jurisdiction, it is without right or authority to consider the merits (*State of South Carolina* v. *S. C. Electric Co.,* 41 F. Supp. 111) and can not even award costs (*Rucker* v. *Wheeler,* 127 U. S. 42; *Citizens Bank* v. *Common,* 164 U. S. 324; *Songth* v. *Asphalt Belt Ry.,* 267 U. S. 326) and such decisions can not be set up in bar. *Walden* v. *Bodley,* 14 Pet. 161; *U. S. Fastener Co.* v. *Bradley,* 143 F. 530.

Even if, in that former action, the court had authority to and did decide that the predecessor, the taxpayer for the years in that action, was not entitled to allowances for depreciation computed on the basis of the fair market value as of March 1, 1913 of property acquired by it throughout the years 1903 to 1913, such decision could not act in bar, in this action, against the claim of this petitioner, the taxpayer for the years in this action, a later period, that it is entitled to allowances for depreciation of property purchased by it, on June 30, 1922, from the predecessor, computed on the basis of the fair market value thereof as of June 30, 1922, a different basic date. The facts existing at the time of the accrual of the taxes involved are controlling. (*Reo Motors, Inc.* v. *Comm.,* 338 U. S. 442)

At the time the taxes accrued and became a liability of the predecessor, involved in the former action, the property belonged to the predecessor and its sale was not under contemplation, it consisted of the plant built in 1903 and additions thereto acquired in the taxable and intervening years, and the taxpayer's claim of being entitled to allowances for depreciation computed on the basis of the fair market value as of March 1, 1913, related only to that part of the property that was acquired before March 1, 1913.

At the time the taxes, involved in this action, accrued as a liability of this petitioner, a considerably different property and basic date was involved. Although the petitioner's claim for an allowance for depreciation computed on the basis of a fair market value as of June 30, 1922 involves only the property it acquired from the predecessor on June 30, 1922, that property as a whole differs considerably from that involved in the former action. The property had a productive capacity of two million yards when sold on June 30, 1922, whereas, on March 1, 1913 its productive capacity was only one million yards (R. 110).

With respect to the application of the theory of res judicata, where the taxes have accrued under different revenue acts, this Court stated in the case of *Comm* v. *Sunan*, 333 U. S. 591, 601, that, "It naturally follows that an interposed alteration in the pertinent statutory provisions * * * can make the use of that rule unwarranted." Not only does the petitioner's claim involve a different property, a different set of facts, a different basic date, but the decision of the court is based on its theory that sections 203 and 204 of the Revenue Act of 1924 governs, that provision differing radically from the provision of section 202 of the Revenue Act of 1921 which was in effect when the petitioner acquired the predecessor's property, as hereinafter discussed. If this petitioner stands in the shoes of its predecessor, as decided by the court, then it has the same right as the predecessor to have its allowances for depreciation computed on the basis of the fair market value as of March 1, 1913.

If it is a separate entity and taxpayer, the petitioner is entitled to allowances for depreciation computed on the purchase cost as of June 30, 1922. Having paid its capital stock for the property, the cost to the petitioner of that property was the fair market value, infra. The court held that the petitioner is entitled only to the cost basis, but by applying the provision of the Revenue Act of 1924, also held that the cost must not differ from the cost used by the predecessor, which cost was dictated by the revenue agent. In essence, the court's decision is, it must but it cannot.

It appears that a claim for refund, claiming that the tax was excessively exacted because an allowance for depreciation was not computed on all of the cost of the depreciable property, is a cause of action, different, separate and distinct from a cause of action consisting of a claim for refund for the very same year and by the same taxpayer, claiming that the tax was excessively exacted because the allowance for depreciation, for that year, was not computed on the basis of the fair market value as of March 1, 1913 or of some other basic date, if the same reasoning is applied as was enunciated by this Court in the case of *U. S.* v. *Henry Prentiss & Co.*, 288 U.S. 73. In that case, involving the same taxpayer, the same taxable year, the same revenue act and the same tax excessively exacted thereunder, and a claim for refund of such overpayment, the taxpayer first claimed that the excessive exaction of the tax was due to an inadequate allowance for a deduction; but later, having failed to obtain a refund, it claimed that, whether or not the Commissioner concedes that the allowance of the deduction is inadequate, the tax was excessively exacted if the provisions of Special Assessment are applied. Having failed to obtain refund under Special Assessment, the taxpayer brought suit for refund of the overpaid tax setting forth its claim that the allowance of a deduction was inadequate. This court held that the claim of an inadequate allowance was one cause of action and the claim that the tax was excessively exacted under consideration of the provisions of

Special Assessment was another cause of action, separate, different and distinct from the other, and that the taxpayer brought its action on the wrong cause of action.

Therefore, when applying the same reasoning as was used by this Court in the case of *U.S.* v. *Henry Prentiss & Co., supra,* to the difference in facts involved, such as the difference in property, taxpayers, amounts of tax overpaid, year for and laws under which the tax liabilities accrued, and the reasons set forth in the claims for refund as to why the taxes had been excessively exacted, particularly involving a basic date of March 1, 1913 in one and June 30, 1922 in the other, it appears that the causes of action, involved in this and the former action, are not the same, and the theory of res judicata does not apply as against this petitioner.

Therefore, the court erred in deciding that the decision of the court in the former action against any additional allowance for depreciation must, under the theory of the application of res judicata bar the claim that the allowance for depreciation should have been computed on the basis of the fair market value, since, even though such basis was not it could have been advanced by the petitioner in that action. As such additional basis would have constituted a different cause of action, and the court had no authority to decide what causes of action there might be and which thereof, if any, the petitioner should proceed on, its decision appears to have been erroneous.

The petitioner, as successor to Union Bleaching & Finishing Company, appealed from a determination of the Commissioner and a decision of the United States Board of Tax Appeals (now Tax Court) affirming it, that there is a deficiency for the taxable periods, 1920, 1921, and the first half of the year 1922, taxable periods preceding the petitioner's existence. The United States Court of Appeals for the Fourth Circuit affirmed the decision of the Board. 97 F. (2d) 226.

The Board of Tax Appeals (R. 222) and the court affirming (R. 238) both stated that there were only four issues involved namely: (1) Whether the Board * * * lacked jurisdiction * * * (2) whether the tax is barred by the statute of limitations (3) Whether the Commissioner erred in disallowing claimed additional deductions * * * for items of equipment purchased and charged against depreciation reserves, and (4) Whether the Commissioner erred in refusing to allow a deduction * * * on account of income tax both imposed by and paid to the State of South Carolina * * *."

The statement of the issues involved negatives any conclusion that any issue was involved such as inadequate allowances for depreciation or whether allowances therefor should be computed on the basis of a fair market value.

The only question concerning depreciation was the petitioner's contention that, if it is not allowed to deduct the cost of certain items of equipment purchased for repairs, then the cost thereof should be added to the property account rather than be charged to reserve for depreciation and that depreciation should be deducted and allowed with respect thereto in the same manner as the other depreciable property and at the same rate.

Aside from the matter of depreciation, that decision would not be controlling in this action as against this petitioner for the reasons that; the petitioner as purchaser of the property and assignee of chose in action is not the taxpayer Monarch Mills successor to *Monarch Cotton Mills* v. *Jones,* 56 F. (2d) 180. Consideration of public policy, supporting the rule of res judicata, does not bring to mind any justification of its extension to make a fact adjudicated in any action between a party, an assignee of chose in action, and another party, res judicata in a subsequent action between the parties in their individual capacities. *Fuller* v. *Metropolitan L. Ins. Co.,* 35 A. 766. In that action the respondent was the Commissioner, whereas, in this action the respondent is the United States. Therefore, concur-

rence of identity of the parties fail on both sides. To make a judgment res judicata in a subsequent action there must be concurrence of identity in four respects of subject matter, of cause of action, of persons and parties, and in the quality of the persons for or against whom the claim is made. *N.P. Ry.* v. *Snohomish County,* 172 P. 878; *Vincent* v. *Mut. Reserve Fund Life Assn.,* 58 A. 963; *Cherry* v. *York,* 47 S. W. 184; *Hoffmeier* v. *Trost,* 85 A. 221.

As the respondent, defendant in this and that former action, urged the finding and decision, in that former action, that the Commissioner properly rejected most of the petitioner's claims for refund on account of amortization and that, on June 30, 1922 the predecessor sold it property, including most of the war facilities on which the petitioner claimed amortization, in exchange for the petitioner's capital stock, without apparent loss (R. 133, 166), thereby defeating most of the petitioner's claim for amortization and permitting the respondent to retain money illegally exacted from the predecessor as a tax, the respondent is estopped by conduct from contending in this action, that the predecessor did not sell its property; and the court erred in deciding that the property was not sold, but was exchanged, on June 30, 1922, pursuant to a plan of reorganization. (R. 132)

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 2. In failing to explain, why it had decided in the former action that the predecessor sold the property to the petitioner, thereby defeating the petitioner's claim in that action; why, when holding that former decisions are controlling in this action, it specifically exempted the decision that the predecessor sold its property to this petitioner; and why it decided, in this action, in the direct contradiction to its former decision, that the property was not sold but was exchanged pursuant to a plan of reorganization to the defeat of the petitioner's claim in this action, thus defeating the petitioner's claims in both actions on the basis of decisions diametrically opposed with respect to the same transaction.

In that former action the court held that the predecessor purchased war facilities at a cost of $76,468.57, sustained a loss of $7,674.85 upon the discard and sale of a part thereof costing $12,129.66, resulting in an overpayment of tax, for the year 1918, of $5,840.23; (R. 166) and that the Commissioner correctly determined that, with respect to the amortized war facilities the predecessor did not sustain a loss for the reason that, on June 30, 1922, the remaining war facilities together with, all the other property of the predecessor was sold to the petitioner in exchange for the petitioner's capital stock, therefore, without any apparent loss.

Where property has been purchased and paid for in capital stock, the cost of acquirement of the property and the price received therefor has been held to be the value of the stock at the time paid for the property, and that the value of the stock is equal to the fair market value of the property at the time for which it was paid. (*Hazelton Corp.* v. *Comm.*, 89 F. (2d) 513; *Rice* v. *Comm.*, 47 F. (2d) 99.)

Art. 184, Regulations 62, promulgated by the Commissioner under authority of the Revenue Act of 1921, provides;

> "Computation of amortization allowance.—The total amount of amortization allowance is the difference between the original cost of the property if * * * acquired on or after April 6, 1917 * * * less any amounts deducted for depreciation, losses, * * * and the value of the property on either of the bases indicated below: (1) In the case of property which has been sold * * * before March 3, 1924, the value shall be the actual sale price * * * (2) in the case of property not included in (1) above, the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business * * *."

Under the provisions of Art. 184, *supra*, and the fact found by the court that the unamortized war facilities were sold in exchange for the capital stock of the purchaser (R. 165, 202) it appears that the taxpayer did not suffer any loss with respect to the unamortized war facilities and that

the court correctly allowed judgment of only $5,840.23 on the basis that loss was suffered only with respect to the war facilities that were sold before June 30, 1922 (R. 166, 167).

However, under Art. 184, *supra,* had the property not been sold before March 3, 1924 all of the war facilities would have been subject to amortization on the basis of loss of value in actual use. Therefore, had the court in the former action held that the petitioner is the same taxpayer and the same organization as its predecessor, the petitioner would have been entitled to judgment on the basis of an allowance for amortization of the entire cost of the war facilities.

Thus it appears that the petitioner's claim for refund based on a loss with respect war facilities costing $64,339.91 was defeated by the defendant-respondent urging and obtaining the courts decision, in that former action, that the war facilities and other property were sold by the predecessor on June 30, 1922, to this petitioner for stock. Having thereby succeeded in continuously holding property allegedly belonging to the petitioner, the same respondent in this action reversed its position and successfully urged the court to reverse its position and to decide that the property was not sold, but that, on June 30, 1922, the property was exchanged pursuant to a plan of reorganization, thereby, permitting the illegal retention of the petitioner's property, by the respondent, and defeating the petitioner's claim in this action. It is unconscionable for the respondent to urge and the court to decide, in this action the reverse of what the same respondent urged and the same court held in that former action with respect to the sale of the property on June 30, 1922. Having eaten the cake taken from the petitioner in the former action, it can not still have it in this action. The respondent is estopped from contending to the opposite, in this action, of that which it contended in that formal action. The court committed reversable error in deciding that the predecessor did not sell its property on June 30, 1922, to the petitioner and, instead,

that the property was transferred pursuant to a plan of reorganization. Having made such reverse decision as to the transfer of the property, the court should have explained but erroneously failed to explain why it made the contradictory decisions.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 3. In deciding that, because of the facts relating to the exchange of the property and the law with respect thereto, the predecessor and the petitioner is the same taxpayer, the petitioner stands in the shoes of its predecessor and is not entitled to allowances for repairs and depreciation computed on any other basis or in any other manner than was allowed to the predecessor, right or wrong; and, in failing to decide that, under the provisions of section 202 of the Revenue Act of 1921, the separate entities of the petitioner and predecessor corporations are recognized, the sale of the property is considered as having been negotiated at arms length, and, recognition of gain or loss, if any, is not barred as between the said corporations, and that the section bars recognition of gain and loss only as between individuals.

The provisions of the said section 202 of the Revenue Act of 1921 were clearly intended as a curb only of individuals in their effort to devise ways and means to evade their individual tax liabilities. During the period subsequent to World War One, there were necessarily many reorganizations particularly of concerns that sprang up during the war and that were needing to be integrated into the postwar economy. The reorganizations provided opportunities for individual stockholders to manipulate their stock exchanges in the reorganizations in such manner, that, upon any subsequent sales or of exchanges of such stock, it would appear that they sustained deductible losses, whereas, no actual losses may have been sustained. Corporations being inoperative without the direction of individuals, and having no thought or intention of tax evasion, the curb of section 202

was aimed at the individual only, proof of which appears in the wording of that section. Although the revenue acts provide that the word "person" when used therein may mean corporations as well as individuals, it would be unreasonable to conclude that a corporation was being specified in any provision of such act where the term "person" was used and referred to as "him", as in sub-paragraph (c) (2) of section 202.

While considering the proposed Revenue Act of 1924, and particularly sections 202, 203, and 204 of the proposed act to take the place of section 202 of the Revenue Act of 1921, The Senate Committee on Finance, in its Report No. 398, Sixty-eighth Congress, First Session, in holding that the provisions of section 202 of the Rev. Act of 1921 providing that gain or loss shall not be recognized under certain circumstances, relates only to individuals and not to corporations, stated that the paragraph:

> "* * * provides that no gain or loss is recognized if a corporation a party to a reorganization exchanges property for stock or securities in another corporation a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law."

Therefore, the court erred in deciding that any gain or loss that may have resulted from the sale, on June 30, 1922, of the predecessors property to this petitioner is barred from recognition and that as a result of such transaction the predecessor and petitioner corporations lose their separate identities for tax purposes.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 4. In deciding that, for the purpose of this action, the transaction, whereby the property changed hands on June 30, 1922, must be construed under the provisions of sections 202, 203, and 204 of the Revenue Act of 1924, and similar provisions of the later revenue

acts instead of under the provisions of section 202 of the Revenue Act of 1921 which was in force when the transaction occurred, its decision being in conflict in both result and theory with the decision of this Court in the case of Reo Motors Inc. v. Commissioner (decided January 9, 1950), 338 U. S. 442.

The court erred in deciding that the transaction, as of June 30, 1922, must be construed under the provisions of sections 203 and 204 of the Revenue Act of 1924 and similar provisions of subsequent revenue acts, such decision being both in result and theory in conflict with this Court's decision in the case of *Reo Motors Inc.* v. *Comm.*, 338 U. S. 442.

The decision of the court should now be considered in the light of this Court's decision in *Reo Motors Inc.* v. *Comm., supra.* Under the provision of section 202 of the Revenue Act of 1921, the separate identity of the predecessor and petitioner corporations is preserved, they are not the same taxpayer, the predecessor sold the property to the petitioner, on June 30, 1922, in exchange for the petitioner's capital stock, as was decided by the court in the former action, and the petitioner is entitled to allowances for depreciation computed on the basis of the fair market value of the property as of June 30, 1922, the selling price.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

5. In deciding that, for 1928 and all prior years, the Commissioner correctly allowed the petitioner deductions for depreciation computed on the book record of the cost of the property as of December 31, of each preceding year respectively, less the cost of property determined to have been fully depreciated, and that the petitioner is not entitled to allowances for depreciation computed on the basis of the fair market value of the property as of either June 30, 1922 or March 1, 1913.

The trial court erred in deciding that the Commission correctly computed the allowances for depreciation on the cost of the petitioner's property.

In the former action, the court decided that on June 30, 1922, the predecessor sold its property to this petitioner in exchange for the petitioner's capital stock. (R. 165) The purchase price paid for the property was the value of the petitioner's capital stock, on June 30, 1922, when paid for the property, and the value of capital stock was equal to the fair market value of the property as of June 30, 1922 for which it was paid. *Hazeltine Corp.* v. *Comm.*, 89 F. (2d) 513; *Rice* v. *Comm.*, 47 F. (2d) 99.

But, the petitioner's books did not record the fair market value of the property, the cost of purchase thereof, as of June 30, 1922. The petitioner was required by the revenue agent, who examined the books of the predecessor and petitioner, to make no change in the book record after June 30, 1922, and to extend and continue the books of account, with the exception of the change in name of the corporation, as if there had been no change in ownership of the property. (R. 93, 100) Thus, with the exception in change of name of the corporation, the petitioner's books are a continuation from their earliest entries in 1903. Therefore, the petitioner's books of account did not reflect the sale or purchase price of the property, which it purchased from the predecessor on June 30, 1922, when the book record of the cost of depreciable property is only in the amount of $1,374,860.99, (R. 183), whereas, the fair market value of the property on that date was not less than $4,006,680.00. Much of the difference between cost and value being due to the fact that the books then and at all times prior thereto did not reflect all of the costs. It appears that this Court should take judicial cognizance of the well known fact that prior to March 1, 1913, before income taxes were being exacted, and before revenue agents began examining tax payers books of account, taxpayers generally either wrote-off excessively their plant account, or failed to include in their plant account much of the cost of their property, in accordance with a conservative policy prevalent amongst business men and manufacturers at that time. Having

knowledge of such fact the United States Congress provided in the revenue acts, that, in the sale or other disposition of property, after March 1, 1913, of property acquired before that date, any gain realized or loss sustained shall be computed on the basis of the fair market value of that property as of March 1, 1913.

Knowing that, in the determination of net income, it would be necessary to determine gain or loss from the sale or other disposition of property and that the usual basis for determination would be the cost; but that the cost of property that was acquired before March 1, 1913 could not be determined, in many instances, on account that the records had been destroyed or that persons who were familiar with the facts are either dead or otherwise not available; and, knowing that considerable relief and justice would result, if the fair market value was to be substituted for the cost as a basis, the Congress provided, in sections 202 and 234, Rev. Act of 1921, that the basis of such determinations, including allowances for depreciation, shall be the fair market value as of March 1, 1913, or as of any other basic date, such value being equivalent to an agreed upon sale and purchase value by a willing seller and a willing buyer, neither being forced to buy or sell, and both having knowledge of the facts. Art. 1563, Reg. 45. (R. 18)

Knowing that most taxpayers, pursuant to a conservative policy of management and accounting, had, prior to January 1, 1917, excessively charged off the cost of their properties, the Commissioner promulgated articles 831 to 844, inclusive, *infra,* providing that such excessive charge offs may be restored to the property and surplus accounts.

The provisions of articles 831 to 844, inclusive, *infra,* would have applied to the predecessor for the years in this action had it continued the business, and they apply as well to this petitioner, especially if, as the trial court held the predecessor and the petitioner are the same parties. (R. 129)

Being entitled to an adjustment of its property records as provided by articles 831-844, *infra*, and the Commissioner being under compulsion to allow deductions for depreciation computed on the basis of the fair market value as of March 1, 1913, the court erred in holding that "neither reason or authority supports the view that * * * the taxpayer may ignore what has been done by the old corporation * * * ". (R. 292)

Adjustments of the book records, permitted under articles 831 to 844, inclusive, hereinafter show that depreciable property was acquired before March 1, 1913 at an actual cost of $1,172,658.25 (Sch. 1-B), whereas, the book record of such cost is only $428,895.48, and that the cost of such property had been charged to expense and against surplus to the extent of $743,762.77 infra.

Pursuant to a conservative policy of management and accounting, the taxpayer's predecessor, prior to March 1, 1913, charged off to expense and against surplus most of the cost of its depreciable property. Before March 1, 1913 and the beginning of the taxation of profits, such former conservative policies were reasonable and worked to the advantage of the business. If the business was profitable, the management thought that its business was the best place for their stockholders to invest their share of the net profits. If the business was profitable, the management generally wanted to expand it. To finance such expansion with the surplus on hand resulted in the saving of heavy charges of investment bankers, delay, security, and independence in management. However, after March 1, 1913, when profits were being taxed, the condition of the book records became a twofold disadvantage, and unless the records were subsequently adjusted to reflect the facts correctly, the taxpayer's net income and taxes due for all subsequent years would be excessively determined, collected and paid.

On the face of the record, it clearly appeared that the plant, as it existed on March 1, 1913, was larger in capacity and much larger in size than that of the aggregate of additions added thereto between March 1, 1913 and July 1, 1922,

whereas, the book record of the cost as of March 1, 1913 was less than half of the book record of the cost of the additions thereto added between March 1, 1913 and July 1, 1922. However, the Commissioner did not determine whether and to what extent costs of the property had been excessively charged to expense. The capacity of the predecessors plant was 2,000,000 yards, on July 1, 1922, and better than 1,000,000 yards, on March 1, 1913, as testified by Mr. McPherson, whose firm of engineers built all of the additions thereto acquired in 1907 and subsequent years. (R. 110)

Mr. Epps, a revenue agent, in the former action for the years 1916 to 1919, inclusive, testified that he assisted in the examination of the taxpayer's records and in the preparation of the Defendant's Exhibit 4, showing the actual production in yards for 1929 and prior years (p. 82, Def. Ex. E) which exhibit D is printed, on pages 115 and 116 of Def. Ex. E, and shows that the actual production in yards, for the years 1913 and 1922, are 33,324,292 and 60,211,456, respectively. Assuming, that the actual production reflects the capacities in 1913 and 1922, it appears that the actual production in 1913 was 55.35% of the actual production in 1922, and that the capacity of the plant as of March 1, 1913 is at least 55.35% of the capacity in 1922, or that the capacity on March 1, 1913 is about 1,107,000 yards, which substantiates Mr. McPherson's testimony that the capacity is more than one million yards on that date. It thus appears that the capacity added between March 1, 1913 and July 1, 1922 is only 44.65% of the total.

Although the capacity of the plant, as of March 1, 1913, is 55.35 per cent of the capacity thereof, as of July 1, 1922, it is reasonable to assume that the actual cost of the plant, as of March 1, 1913, is in excess of 55.35 per cent of the actual cost as of July 1, 1922. Usually, an increase in plant capacity does not require a proportionate increase in physical size and cost. Usually some of the machinery and equipment of the original plant is of excess capacity, and, if operated throughout the regular operating time of the plant

as a whole, would produce greatly in excess of the requirements of the plant as a whole, and, therefore, is operated only part time. Usually, the land and building areas are originally of sufficient size to permit of a considerable expansion of the original plant. For example, by comparing $3,447.75, the actual cost of land acquired between March 1, 1913 and July 1, 1922, (R. 182), when costs were correctly entered in the property account under the direction and supervision of the revenue agents (R. 100), with $21,081.00 the book record of the cost of land acquired before March 1, 1913, (R. 182) when some of the costs of land may have been charged to expense as was the costs of other property, it clearly appears that the amount of land needed for the expansion after March 1, 1913 was disproportionately less than that which was needed for the original plant. Similarly, as in the case of land, the amount of machinery, equipment, and buildings additionally required for the expansion after March 1, 1913 may have been disproportionately small in comparison with the capacity and the amounts thereof acquired before March 1, 1913.

A presumption exists that the taxpayer's plant account reflects the actual costs of additions thereto acquired after March 1, 1913, since, on that date the first income tax Act took effect, and the taxpayer's books were thereafter kept under the direction and supervision of the revenue agents, (R. 93, 100) and that the actual cost of the additions of depreciable property acquired between March 1, 1913 and July 1, 1922 is $945,965.51, as computed in Schedule 1, *infra:*

SCHEDULE 1.

Cost of depreciable property, plant less land, as per book record (R. 182):	
July 1, 1922 (R. 182)	$1,374,860.99
March 1, 1913 (R. 182)	428,895.48
Actual cost of additions acquired between March 1, 1913 and July 1, 1922, plant exclusive of land	$ 945,965.51

As 44.65 per cent of the plant capacity of the plant was acquired between March 1, 1913 and July 1, 1922 at an actual cost of $945,965.51 (Schedule 1, *supra*) and as the cost thereof is disproportionately less than the actual cost of acquiring the original 55.35 per cent of the capacity as of March 1, 1913, it appears that the actual cost of the plant, exclusive of land, as of March 1, 1913 is in excess of $1,172,658.25, as computed in Schedule 1-A, *infra:*

SCHEDULE 1-A.

Actual cost of 44.65 per cent of capacity, acquired since 3-1-1913	$	945,965.51
Cost of 100 per cent, at same rate, $945,965.51, divided by 4465, is	(A)	2,118,623.76
Actual cost of plant, less land, on March 1, 1913, exceeds	$	1,172,658.25
Note A: The actual cost of depreciable property on 7-1-1922 is	$	2,118,623.76

It appears that, prior to March 1, 1913, the taxpayer charged costs of depreciable property to expense to the extent of at least $743,762.77, as computed in Schedule 1-B, *infra:*

SCHEDULE 1-B.

Actual cost of depreciable property, on March 1, 1913, exceeds	$1,172,658.25
Book record cost thereof on March 1, 1913 (R. 182)	428,895.48
Costs of property charged to expense before 3-1-1913 exceeds	$ 743,762.77

The plaintiff has established that the fair market value of the predecessor's property, as of March 1, 1913, and as of June 30, 1922, is greatly in excess of the depreciated cost and of the book record of cost thereof as of those dates. As a witness for the plaintiff, Mr. Jno. W. Arrington, Treasurer for the plaintiff, who had been employed by the pred-

ecessor during approximately the last 15 years of its operations, testified that the predecessor had been organized in 1902, under the laws of the state of New Jersey, and had started the business now owned by the plaintiff in 1903; that the business had been operated at a loss and the company was in serious financial difficulties by July, 1904, whereupon, his father was prevailed upon to take over the management; that two other plants, in the same line of business, had started in the South but had gone out of business about the time the predecessor started; that the Trade had always looked to the New England states for bleaching and finishing work, and the predecessor had to overcome the prejudice existing against finishing in the South; that prior to 1900 most of the textiles manufactured in the South were heavy goods for export, very few of which were finished; by 1900 print cloths began to be manufactured in the South and the predecessor believed there was an opportunity to start its plant; that in the beginning the predecessor could not obtain experienced help in the South, and all of its key employees had to be brought down from the New England states; and it took about six or seven years before the operations of the predecessor changed from loss to profit; that he first started to work for the predecessor in 1906 assisting the bookkeeper, at which time his father was President and Treasurer of the predecessor corporation; that in 1908, he took complete charge of the predecessor's books. (R. 93) The witness further testified that by March 1, 1913, the predecessor's officers expected the future earnings of the business to be about such as were earned during the years 1918 to 1928 (R. 97-99) and that the management believed they were on the right track, as subsequent earnings had proven; that the predecessor's bleachery was the first in the South to demonstrate that it was a success, and its opportunities were enlarging continuously; and, in his opinion, on March 1, 1913, the fair market value was in excess of the book value of the plant by from three to four times. (R. 98)

Mr. John A. McPherson, Chief Engineer and a member of the firm of J. E. Sirrine & Company, Industrial Engineers, testified for the plaintiff; that he was connected with his firm ever since 1902; that his firm was employed by the predecessor, beginning in 1907, to advise concerning operations and expansion, and to design and supervise the construction and installation of additions to its plant, from time to time; that he and his firm, for many years, have kept records of the cost of construction of plants and the acquirement of various elements going into such cost such as building materials, machinery, labor, etc., by use of which he is able to compute the cost of replacing any plant in any year; he stated what were the main items comprising the predecessor's plant, the various types of machinery and their use and purpose, and described the process and operations of the predecessor's plant; that he and his firm had a detailed inventory of the plant, as it stood in 1907, and of all additions thereafter added, together with detailed cost thereof, by use of which he is able to compute the replacement cost new of the predecessor's plant, as of March 1, 1913, and as of June 30, 1922; that he computed the replacement cost new of the predecessor's plant, as of March 1, 1913, to be $628,305.65, exclusive of inventory, but inclusive of land at book record cost, (R. 110) and, as of June 30, 1922, to be $1,849,123.06, exclusive of inventory, but inclusive of land at the same book record cost. (R. 113) The witness also testified, that he observed the condition of the predecessor's plant, from time to time, whereby he is able to determine its condition in comparison with when new, and/or to determine the accrued depreciation thereof and the depreciated replacement cost; that he estimated that the plant, taken as a whole, on March 1, 1913, was in a condition of 92½ per cent. as good as if new, or that accrued depreciation was 7½ per cent., or that the depreciated replacement cost, as of March 1, 1913, is $582,790.79. (R. 111) With respect to a determination of the fair market value of the predecessor's plant, the witness testified: that

the replacement cost would be the lowest factor to consider, since the predecessor was a going concern and had a going concern value; that a going concern value would reflect a greater value than the replacement cost, that the extent of the excess of the going concern value over the replacement cost depends on what the world prospects are for this industry; the predecessor's plant was expanded from a 500,000 yard capacity in 1907 to a 2,000,000 yard capacity in 1922; (R. 109) and, that he would estimate the fair market value of the predecessor's plant, and other plants of the same history, as of June 30, 1922, at ten times the earnings for the year 1922, in other words, in accordance with his personal yard stick, a plant earning $100,000.00 would have a fair market value of $1,000,000.00. (R. 115)

Notwithstanding having insisted upon the plaintiff taking its deductions for depreciation on the same basis as that of its predecessor, the Commissioner disallowed deduction taken on that basis in the amount of $1,474.37 for the year 1923 (Jt. Ex. D); $5,683.44 for 1924; $3,546.07 for 1925; $4,069.67 for 1926 (Jt. Ex. M-1); $3,506.58 for 1927 (Jt. Ex. U-3) and $2,880.11 for the year 1928. (Jt. Ex. Y). These disallowances were partially arrived at by the Commissioner's determinations; that some costs had been fully depreciated and that no further deductions for depreciation thereon is allowable.

Mr. McPherson, having qualified as an expert in valuing industrial properties and business, testified, in effect, that in estimating a fair market value of any industrial plant and business for consideration of clients of his engineering firm in either buying or selling, he takes into account various factors; the value of the physical property, the type of products produced or to be produced, whether the plant or business is a part of an obsolete, static or rising industry, the going concern value thereof, whether that going concern value may decrease or increase in the future, and what are the future prospects of the business, some of which may add or detract from the cost or value of the

physical property. He also testified that any successful business has an intangible value, called a going concern value, which attaches to the physical property and the business, which must be added to the cost or value thereof. (R. 107-115) In explaining why it was of great importance to consider the future prospects of the business from the standpoint of world demand for its products, and why it is that in a declining industry the present and past history of net earnings would have to be fully discounted, Mr. McPherson used as an example, an assumed case of a buggy manufacturing business and an automobile manufacturing business, some thirty years ago, assuming both to have the same amount of capital invested, the same replacement values, the same volume of sales and at that time the same amount of net profits, yet their fair market values would greatly differ; that any one observing the trend of the times and the rapid tendency of replacing the buggy with the automobile would estimate that the buggy manufacturing business would thereafter suffer an ever decreasing volume of sales and soon would be operating at a loss, and that its going concern value of the past was valueless for the future, would add nothing to the physical property cost, and the fair market value might be less than the depreciated original cost, whereas, in the case of the automobile manufacturing business, the fair market value might greatly exceed the depreciated cost of the property, its future being bright with the prospects of ever increasing volume of sales and net profits to be earned. He further testified that where a business has been successful and has good prospects for continuing successfully, he estimates that it has a going concern value of ten times the average net annual profits, and that he would estimate the going concern value of the taxpayer's business as of either March 1, 1913 or as of July 1, 1922 to be ten times the amount of its average annual net profits, which value should be added to the original cost of the property less accrued depreciation, (R. 115) in support of which, he further testified that,

"They built * * * or put into that plant, in the way of organization, sales efforts and personnel that cost a great deal of money, which is not reflected in the physical assets, yet it went into the estimate of sales outlets and the reputation amongst the trade for its output, which meant that as the years went by it profited highly on that investment that they had put into their plant. That, of course, adds to the market value of the property." (R. 115)

Knowing that a going concern value, like the value of a patent, becomes attached to the property, and that in determining the fair market value of the business, it must be added to the depreciated cost of the property, the Commissioner promulgated articles 41, 843 and 1561, Reg. 62, providing:

> Art. 843. " * * * From the standpoint of assets a patent, or * * * a group of patents, is closely analogous to good will. Their value is *contingent* upon and measured by their earning power. * * * and in a successful business the patent value merges * * * into a trade name or other form of good will." (Emphasis supplied.) Their value is measured on an estimate of future profits expectant.

> Art. 41. " * * * Any profit or loss resulting from the sale of good will can be taken only when the business or a part of it, to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will. If the good will was acquired prior to March 1, 1913, the taxable gain or deductible loss should be ascertained in accordance with the provisions of article 1561."

> Art. 1561. " * * * For the purpose of ascertaining the gain or loss from the sale or exchange of property, the basis is the cost. * * * But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain to be included in gross income is the excess of the amount realized therefor over such fair market value."

According to the regulations, if the property was acquired after March 1, 1913, the gain or loss will be determined on the basis of the cost of the property, including the cost of the good will. If the property was acquired before March 1, 1913, and thereafter sold, the gain or loss will be determined on the basis of the fair market value of the property, including the fair market value of the good will.

The taxpayer's surplus account is understated in its books and excludes most of the net profits earned prior to March 1, 1913. Theretofore, the predecessor charged against surplus costs of depreciable property in the amount of $743,762.77, as computed in Schedule 1-B, *supra,* and $24,000.00, the amount of dividends paid in 1911. (R. 164) For the period, December 31, 1904 to March 1, 1913, the surplus account shows profits earned only in the amount of $98,312.50, whereas, net profits were earned in that period in the amount of $866,075.27, an average annual net profit of $106,050.036, as computed in Schedule 2, *infra.*

When applying Mr. McPherson's formula (R. 115) to the average annual net profits earned prior to March 1, 1913, it appears that the predecessor had a going concern value on March 1, 1913 of $1,060,500.36, in excess of cost, as computed in Schedule 2, *infra.*

As the actual cost of the predecessor's depreciable properly acquired before March 1, 1913 is $1,172,658.25 (Schedule 1-A) and its going concern value was $1,060,500.35 on that date, it appears that the fair market value of its property, exclusive of land, is $2,233,158.61, as computed in Schedule 2, *infra:*

SCHEDULE 2.

Deficit, as per books, on 12-31-1904 (R. 182)..	$ 31,356.52
Surplus, as per books, on 3-1-1913 (R. 182)...	66,955.98
Net profits earned, as per books, 12-31-04 to 3-1-13 (R. 182)	$ 98,312.50
Dividends paid in 1911 (R. 164)	24,000.00
Cost of plant charged to expense and surplus (Sch. 1-B, *supra*)	743,762.77

Net profits earned, 12-31-04 to 3-1-13, period of 8 and 1/6th years	$	866,075.27
Average annual net profits earned for the period, $106,050.036		
Going concern value, McPherson formula, 10 × $106,050.036		$1,060,500.36
Actual cost of property, exclusive of land, on 3-1-13 (Sch. 1-A, *supra*)		1,172,658.25
Fair market value as of March 1, 1913		$2,233,158.61

Although the fair market value of the property, exclusive of land, as of March 1, 1913, was computed at $2,233,158.61 on the basis of profits earned prior thereto (Schedule 2, *supra*) it would not have been error to have computed it on the basis of expectant future profits, as admitted by the Commissioner in promulgating the regulations, providing:

> "Art. 1563. Reg. 45. * * * Market value is the price at which a seller willing to sell at a fair price and a willing buyer willing to buy at a fair price, both having reasonable knowledge of the facts, will trade. * * * ."
>
> "Art. 1561. Reg. 62. * * * What the fair market value of property was on March 1, 1913, is a question of fact to be established by *any* evidence which will reasonably and adequately make it appear."

In determining the fair market value of a buggy manufacturing business, some thirty years ago, the most reasonable thing for both the buyer and seller to consider, is that the buggy manufacturing business would soon be put out of business by the automobile manufacturing business, that the past history of profits earned will not continue and should be completely discounted, and that in the near future there would be no profits earned and the property would only have either a junk or reconversion value. Based on facts probably known to both, the agreed upon buying and selling price would be considerably less than it would have been if based on past profits. In the case of the automobile

manufacturing business, at that time largely experimental, there may have been very little profit, but, there was a latent intangible asset, the value of which is contingent on future profits to be earned. Based entirely on the future world demand for automobiles, the price at which a willing seller and a willing buyer would agree upon might greatly exceed the depreciated cost of the depreciable property. Art. 843, *supra,* provides that, "From the standpoint of assets, a patent * * * or group of patents * * * is closely analogous to good will. Their value is *contingent* upon and measured by their earning power * * *." The patent and the good will have the earning power even though not yet demonstrated. If every one refused to believe that the patent or good will had value until it was demonstrated by profits earned, there would be neither patents or good will, since there would be no incentive for risk capital to invest therein. The incentive to risk capital has been the basis for the remarkable progress of our country in business and production, the belief in an existent value though not yet demonstrated. That a patent and good will value may be valued on the prospect of future profits was held in the case of *Rockwood Pottery Co.* v. *Comm.,* 45 F. (2d) 43.

It clearly appears that the trial court erred in holding, and that this Court erred in affirming it, that the appellant wrongfully claimed a fair market value computed on the basis of profits earned subsequent to the basic date. The old adage continues true that "the proof of the pudding is the eating thereof". The value of good will, like the value of a patent, as of the basic date, is, on that date, contingent on the profits to be earned. In this case the contingency no longer existed. The previously expectant profits to be earned after the basic date have been earned, thus establishing proof of that value as of the basic date which had been, but now is, no longer contingent but a reality. However, Schedule 2, *supra,* shows the fair market value computed on the basis of prior earnings.

Notwithstanding the provisions of law to the contrary, the Commissioner, in determining the net income, for 1910 and each subsequent year, allowed depreciation of property acquired before March 1, 1913, computed on the book record of cost as of December 31 of the year preceding, respectively, having failed to determine a basic date, a value as of the basic date, or to allow depreciation on the basis of such value. The Commissioner's determinations of allowances for depreciation for all years were made in accordance with recommendations contained in Revenue Agents Reports, each of which are hereinafter referred to as R.A.R. (Pl. Exs. 1 and 2; Jt. Exs. M-1, U-1, U-2, U-3; and R.A.R. dated Apr. 24, 1926, p. 120 to 145, Def. Ex. H), all of which varied.

In a former action for the years 1916 to 1919, inclusive, Mr. M. H. Epps, a revenue agent, testified, with respect to the book record of the cost of the depreciable property, "I also made an examination of the books of account * * * to ascertain the plant account as carried upon the books over the period 1904 through 1926. * * * (p. 82, Def. Ex. E.) As to the basis on which the allowances of depreciation was computed, Mr. Epps, testified, "the base is cost". (p. 83, Def. Ex. E.) That statement shows the book record of the cost of the taxpayer's depreciable property, on December 31, of the years 1915 to 1918, inclusive, on which the Commissioner computed depreciation for the years 1916 to 1919, inclusive, respectively, as shown in Schedule 3, *infra:*

SCHEDULE 3.

As of December 31: Years	1915	1916	1917	1918
Brick Buildings	$119,904.47	$123,602.00	$124,110.37	$136,786.14
Frame Buildings	32,574.29	50,515.04	61,266.47	70,326.91
Machinery	288,113.03	310,834.84	349,400.02	369,428.53
Fur. & Fixtures	2,766.58	2,889.80	3,096.70	3,107.94

The Findings of Fact and Conclusions of Law, adopted by the trial court, in a former action for the years 1916 to 1919, inclusive, constituting that court's decision, (p. 29 to 44, Def. Ex. E) contains Paragraph XVII, stating:

"The Commissioner * * * allowed as deductions * * * the following amounts on account of wear, tear, exhaustion and obsolescence * * *:

Year	*Deductions allowed*
1916	$15,689.65
1917	23,792.41
1918	26,664.37
1919	28,573.18

* * * The rates of depreciation allowed * * * are as follows; on machinery 6%; on furniture and fixtures 5%; on brick buildings 2%; and on frame buildings 5% * * *" (p. 38, Def. Ex. E). (R. 203)

Proof that the Commissioner computed allowances for depreciation for 1919 and each of the prior years, by applying the rates prescribed in Par. XVII, *supra,* to the book record of cost as of December 31, of each year preceding, respectively, is had in a recomputation of his allowance of depreciation for the year 1919, based on the cost as per books as of December 31, 1918, in the amount of $28,573.18, as shown in Schedule 4, *infra:*

SCHEDULE 4.

	Book record cost on December 31, 1918:	*Rate %*	*Allowances for depreciation*
Brick buildings	$136,786.14	2	$ 2,735.72
Frame buildings	70,326.91	5	3,516.35
Machinery	369,428.53	6	22,165.71
Fur. & fixtures	3,107.94	5	155.18
Depreciation allowed for 1919, Par. XVII, *supra*			$28,573.18

Schedule 3, *supra,* shows that additions were acquired at a book record of cost, in the year 1916 of $44,483.39; in the year 1917 of $50,031.80; in 1918 of $41,775.96; and in 1919 of $13,222.47. The computation in Schedule 4, *supra,* clearly shows that the Commissioner, for the year 1919, and

similarly for all prior years, allowed depreciation computed only on the book record cost as of the close of the preceding year, and that he did not allow depreciation for the year on the cost of additions that were acquired within that year.

Although Mr. Epps testified that the basis on which depreciation was allowed is the cost, it clearly appears that that basis did not include all of the book record of cost, having excluded the cost of additions acquired within the year.

Schedule 1-B, *supra*, shows that the book record cost as of March 1, 1913 and thereafter does not include $743,762.77 the cost of depreciable property that was theretofore charged to expense. Therefore, the basis of cost on which the Commissioner allowed depreciation was exclusive of most of the actual cost, and exclusive of some of the book record cost.

Therefore, the trial court, in this action, referring specifically to the former action for the years 1916 to 1919, inclusive, erroneously stated in his opinion, "In that case the Commissioner used the costs * * * as a basis for depreciation, it also having been the basis on which the plaintiff's books were kept" (R. 128), since depreciation was not allowed on the book costs of additions acquired within the year for which the allowance was being computed, and the book record of costs did not include the major portion of the actual costs.

Fred A. Friend, a revenue agent, who prepared the R. A. R., dated April 24, 1926, covering 1922 and prior years (p. 120-145, Def. Ex. H), testifying in a former action for the years 1920 to 1922, stated, "In computing depreciation allowed, I based the depreciation on the capital account as reflected by the books, that is, the gross asset account unreduced by the reserve for depreciation." (p. 117, Def. Ex. H.)

Although for 1919 and prior years, depreciation was not allowed on the cost of additions for the year in which acquired, depreciation was allowed, for all subsequent years, on the cost of additions therein acquired, in one half of

the amount that would have been computed as an allowance had such addition been acquired on December 31 of the prior year, as computed by Mr. Friend, the revenue agent, as shown in the depreciation schedule, of his R. A. R. (p. 144, Def. Ex. H.)

For 1919 and all prior years, allowances for depreciation on the book cost of furniture and fixtures were computed at the rate of five per cent, per year, as shown in Schedule 4, *supra*, and R. A. R.s, Pl. Ex. 1 and 2, whereas, for 1920 and all subsequent years, the depreciation allowances were computed on the book record cost of furniture and fixtures at the rate of ten per cent per annum, as shown in R. A. R., dated April 24, 1926 (p. 120-145, Def. Ex. H) and all subsequent R. A. R.'s, Jt. Exs. U, U-1, U-2, and U-3.

Notwithstanding that the allowances for depreciation, for 1919 and prior years were computed on different bases and at different rates, than for 1920 and all subsequent years, the first former action was approved by the trial court, and the second former action, for the years 1920 to 1922, was approved by the Board of Tax Appeals, and both former actions were affirmed by this Court, with respect to which, the trial court in this action, held, "I am of the opinion that the plaintiff is precluded by the judgments in those cases." (R. 129.) Since the former judgments related to different bases and different rates, the appellant could not be precluded by both.

The taxpayer and its predecessor is entitled to have the records adjusted to show the facts and to have restored to the property and surplus accounts the costs of property excessively charged off, in years prior to 1917, to have their tax liabilities for all years redetermined for which returns have been filed and to be refunded any taxes overpaid, as provided in articles 831 to 844, inclusive, *supra*. Notwithstanding that the predecessor excessively charged off most of the cost of the property acquired before March 1, 1913, and the same has never been restored to its property and surplus accounts, the Commissioner computed the depre-

ciation for all years on the book record of costs. Under sections 250 and 252, Revenue Acts of 1921 and prior years, *infra*, the Commissioner is under compulsion to determine the correct amounts of net income and taxes due for all years and to refund any taxes overpaid, whether or not the taxpayer's books and returns are correct, and in the determination of which he is compelled, under the provisions of sections 202 and 234 to determine any gain or loss from the sale or other disposition, including allowances for depreciation, of property acquired before March 1, 1913, on the basis of the fair market value thereof as of March 1, 1913. Notwithstanding that the Commissioner failed in his duty in all respects as aforesaid, the trial court held that the Commissioner properly allowed depreciation on the book record costs of the depreciable property.

The appellee regularly employs revenue agents throughout the United States to examine the books of account and records of corporations, their work being under the direction of the Commissioner. These revenue agents, examining such books and records from year to year, have an opportunity to learn the complete history of the taxpayers. They keep the Commissioner supplied with a running record of the facts affecting the taxpayer's tax liabilities as are reflected in the books and records, recommending to the Commissioner such adjustments they desire he should make. In the R. A. R., they state in what regard the taxpayer's return does not conform to its books and records, and in what respect the books do not properly reflect the facts, and they recommend the amount and the method of computing the net income and the tax due. Usually, and as in this case, the Commissioner follows the recommendations of the revenue agents.

An examination of all of the R. A. R.'s, particularly Pl. Exs. 1 and 2, and of the testimony of Mr. Epps and Mr. Friend, hereinbefore set out, show that the revenue agents did not determine the actual cost of property acquired by this taxpayer or its predecessor before March 1, 1913, nor

did they recommend any determination of a value of such property as of March 1, 1913. Basing his determinations on the recommendations of the revenue agents, the Commissioner determined the allowances for depreciation of property acquired before and after March 1, 1913, in the same manner for 1913 and all subsequent years, on the book record cost of the year preceding each thereof. Schedule 4, *supra.*

Pursuant to sections 213 and 233 taxes are exacted upon gain from whatever source realized. In the determination of taxable gain a corporation is entitled to deductions of certain prescribed losses and depreciation. Pertinent provisions of the Revenue Act of 1921, are (Emphasis supplied):

> "Sec. 202 (a) That the basis for ascertaining the gain derived or loss sustained from a sale *or other disposition* of property * * * acquired after March 1, 1913, *shall* be the cost * * * except that—
>
> (b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property * * * acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—(1) If its fair market value as of March 1, 1913, is in excess of such basis, the gain to be included in gross income *shall* be the excess of the amount realized therefor over such fair market price or value; (2) If its fair market price or value as of March 1, 1913 is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; * * *".

The term "or other disposition of property" is meant to include the gradual sale of the property through depreciation allowances, as was held in *Ludy* v. *United States,* 274 U. S. 295. Therefore the provisions of section 202, *supra,* are related to the provisions of section 234 (a) (7), Rev. Act of 1921:

> "Sec. 234. (a) That in computing net income * * * there *shall* be allowed as deductions: * * * (4) Losses

sustained during the taxable year * * * (7) A reasonable allowance for the exhaustion, wear and tear of property * * * including * * * obsolescence. In the case of property acquired before March 1, 1913, this deduction *shall* be computed upon the basis of its fair market value as of March 1, 1913; * * * " (Emphasis supplied.)

The Commissioner having himself destroyed the presumption of the correctness of the taxpayer's books for each of the taxable years, he can no longer use such presumption as an excuse for his failure to have determined the actual cost of property acquired by the taxpayer prior to March 1, 1913. The Commissioner disregarded the presumption of correctness of the taxpayer's books by disallowing deductions for depreciation therein taken and computed on the book record cost, and by his determination of smaller amounts which he substituted therefor and used in determining the taxpayer's tax liability. Having disregarded the presumption of correctness of the books in the matter of determining allowances for depreciation on the basis of the book record cost, in seeking to increase the tax, he should have disregarded such presumption in an effort to find a basis for offsetting the additional tax otherwise determined, to determine the excessive amount of the original costs of property that had been charged to expense prior to March 1, 1913, and to determine the fair market value as of that date and depreciation allowances based thereon.

Since the Commissioner destroyed the presumption of the correctness of the books, and the taxpayer admitted and alleged in its claims for refund that the actual cost and the fair market value, as of March 1, 1913, of property acquired before that date, are both greatly in excess of the book record cost thereof as of that date, such presumption no longer existed, and the trial court erred in holding that, "In the instant case the Commissioner accepted the *total* plant costs as disclosed by the plaintiff's books * * * ", as if the Commissioner had respected the presumption of correctness of

the books. (Emphasis supplied.) Furthermore, the trial court erred in injecting the word *"total"*, since the record does not indicate that the book record cost includes all of the cost. Mr. Epps, the revenue agent, in a former action testified, "I also made an examination of the books * * * to ascertain the plant account as carried upon the books over the period 1904 through 1926. I have that statement" * * * (p. 82, Def. Ex. E) which exhibit is printed on pages 112 and 113 of Def. Ex. E. His statement is clearly to the effect that the exhibit shows only such costs as are recorded in the plant account and that no attempt was made to determine whether the costs of record were inclusive of all the costs.

In Schedule 1-B, *supra*, it is shown that costs of property in the amount of $743,762.77 were excessively written off and not included in the book record of costs of depreciable property as of March 1, 1913 shown at $428,895.48. (R. 182.)

Referring to the former action for the years 1916 to 1919, the trial court held, "In that case the Commissioner used the costs * * * as a basis for depreciation, it also having been the basis on which plaintiff's books were kept." As to this action, the trial court held, "These allowances of depreciation were based upon the *actual* cost as shown on the plaintiff's books * * *" (R. 134) (Emphasis supplied.) Having held that the decision, in the former action, is controlling, the trial court, in this action, erred in its attempt to expand on that former decision by injecting the word "actual" in its decision, since the record and Schedules 3 and 4, *supra*, show that the Commissioner did not allow depreciation on either $743,762.77 or any part thereof, actual costs excluded from the book record of costs, or on the book record costs of additions, for the year in which the additions were acquired.

It was proper for the taxpayer to keep its plant account on the basis of cost and without any relation to the fair market value as of March 1, 1913, since the computation of depreciation allowances on the basis of the fair market

value as of March 1, 1913 of property acquired before that date is an exception to the cost basis provided in section 234 (a) (7), *supra,* involving a separate determination of such basic value as provided in articles 1563, Reg. 45, and 164 and 1561, Reg. 62, *supra.* As the taxpayer's plant account, prior to March 1, 1913, was kept before any income tax act came into effect, such income tax act could not have held the taxpayer responsible for any errors therein, the Congress provided for the substitution of the fair market value as of March 1, 1913 in the place of cost, so that the taxpayer would not suffer injury of an excessive tax because of its theretofore faulty bookkeeping. Therefore, this Court erred in its holding that, "neither reason nor authority supports the view that, * * * the taxpayer may ignore what has been done by the old corporation * * *" It is the Commissioner and not the taxpayer or its predecessor who is required by law to comply with the exception provided for in sections 202 and 234 and to determine the fair market value as of March 1, 1913 of property acquired before that date and to compute the depreciation allowances thereon, therefore, any error committed by either the taxpayer or its predecessor in that regard may be ignored by all. Taxpayers do not determine allowances for depreciation.

Having clearly shown in the computations in Schedule 4, *supra,* that the Commissioner computed all allowances for depreciation, for any year, on the book record of cost as of December 31 of the prior year, and in Schedule 1-B, *supra,* that the book records of cost do not include $743,762.77 actual costs charged off as an expense in years prior to 1913, this Court erred in holding that, "The Commissioner allowed depreciation on the actual cost of properties as shown by the taxpayer's books, with proper allowance for prior depreciation * * *." Clearly the Commissioner did not use depreciated cost as a basis in computing allowances for depreciation.

The taxpayer did not complain as to the estimated useful life periods of the various classifications of its depre-

ciable property and the rates at which depreciation should be computed thereon, having complained only that the depreciation allowances should have been computed on the basis of the fair market value as of March 1, 1913, of property acquired before that date, such basis, requiring adjustment of rates as well as value. For example, the Commissioner determined that the useful life of furniture and fixtures would be ten years and that depreciation thereof should be allowed at the rate of ten per cent per annum. However, if such furniture and fixtures was acquired exactly five years prior to March 1, 1913, it would have only five years useful life thereafter remaining, and the rate at which depreciation should be computed, at the otherwise acceptable rate of ten per cent for full useful life, corrected by virtue of the five-year life remaining a rate, at twenty per cent per annum. Therefore, this Court and the trial court both erroneously assumed that the taxpayer complained of the rates and that it was necessary for the court to find in favor of the rates determined by the Commissioner, although, as was shown such rates were not adjusted as to the basic date, since, the value as of that date was not used.

The trial court erroneously rejected the determination of Mr. McPherson that the accumulated depreciation of the taxpayer's plant as of March 1, 1913, was only 7½% the apparent reasoning of the court being that as the different elements of the plant deteriorated at differing rates such determination would have been impossible. Mr. McPherson's estimate was of the condition on March 1, 1913, of the depreciable property as a whole. (R. 111.) The court's error was first based on its failure to recognize that actual depreciation is to be given more weight than is to be given to theoretical depreciation, and that the determination of the condition of the taxpayer's property as of March 1, 1913, or the accrued depreciation to that date would be very accurate, and was secondly based on the court's failure to take judicial cognizance of the fact that appraisal engineers

and practical men determine the condition and accrued depreciation of property by actual examination of it. For example, had the taxpayer's depreciable property as of March 1, 1913, consisted of two machines, one costing originally $5,000.00 and the other $15,000.00, a total original expenditure of $20,000.00 exclusive of a desk costing originally $50.00. Having frequently examined the taxpayer's property, Mr. McPherson finds upon an examination that an expenditure of about $1,503.00 will restore the machines and desk to a condition as when new, and that the accumulated depreciation is 7½%, $1,503.00 being 7½% of the original cost of the property, the theoretical rate bearing very little relation to the real facts. The court should also have taken judicial cognizance of the fact that prior to 1917, taxpayers generally kept their property in a much better condition of repair than at any time thereafter. It has been held that "accrued depreciation is a fact to be ascertained by inspection" (*Westinghouse E. & Mfg. Co.* v. *Denver Tramway Co.*, 3 F. (2d) 285) "by going and looking at it and making estimates based upon the facts which such examination discloses" (In *Pac. Tel. & Tel.* v. *Whitcomb*, 12 F. (2d) 279) and that, "Facts shown by reliable evidence were preferable to averages based upon assumed probabilities." *Pac. Gas. & E. Co.* v. *San Francisco*, 265 U. S. 403.

As the record shows that the Commissioner disobeyed a specific duty imposed upon him to determine allowances for depreciation on the basis of the fair market value as of March 1, 1913, of property theretofore acquired, the presumption of correctness of his determination no longer exists (*Russell* v. *Comm.*, 45 F. (2d) 100; *Helvering* v. *Taylor*, 292 U. S. 507) and when the Commissioner's determination is shown to have been arbitrarily made, his determination should be set aside. "We find nothing in the statutes * * * that gives support to the idea that the Commissioner's determination shown to be without rational foundation and excessive will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the

correct amount * * * " *Helvering* v. *Taylor, supra.* The trial court erred in approving the Commissioner's determinations, shown to be contrary to law, excessive, and without rational foundation, and in holding that the taxpayer had the burden of proof and had not met such burden.

Therefore it appears that the Commissioner deliberately violated the law in refusing to allow deductions for depreciation computed on the basis of the fair market value as of the basic date and, furthermore, he did not allow depreciation on much of the cost of the depreciable property. The court erred in deciding that the Commissioner correctly determined the allowances for depreciation.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 6. In deciding that the petitioner did not meet the burden of proof resting upon it to substantiate its claim that the fair market value of its property is greatly in excess of the book record cost, and that it is entitled to allowances for depreciation computed on the basis of the fair market value as of the basic date.

The petitioner submitted and there was accepted in evidence documentary evidence showing the erroneous determinations of the Commissioner and his violations of law, and the testimony of three witnesses who qualified as experts, two of whom were in the regular employ of the petitioner and one, a member of a well recognized engineering firm, employed, from time to time, in an advisory capacity. The respondent did not produce any witnesses and did not refute the testimony of the petitioner's witnesses, whose testimony substantiated the petitioner's claims.

Furthermore, the petitioner showed that the Commissioner's determinations, of which it complained, were willfully made in violation of the law and of the regulations promulgated by him, were arbitrary and without rational foundation; that any presumption of correctness that would have otherwise attached thereto was dispelled and no longer exists (*Russell* v. *Comm.*, 45 F. (2d) 100, 103) and

should be set aside (*Helvering* v. *Taylor*, 292 U. S. 507) and the court erred in failing to do that which the Commissioner should have done but failed to do. *B. F. Sturtevant* v. *Comm.*, 75 F. (2d) 316.

Having shown that the Commissioner disallowed the petitioner's deductions in violation of the provisions of law and the regulations in that regard, and that the Commissioner's determinations were arbitrary and without rational foundation, and that any presumption that would otherwise have attached to his determinations have been destroyed, the burden of proof has shifted from the petitioner to the Commissioner as provided in Article 165 of Regulations 62, *infra*. *B. F. Sturtevant* v. *Comm.*, *supra*.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 7. In deciding that the Commissioner properly disallowed as deductions repairs costing more than $5.00.

The Commissioner adopted the revenue agents recommendation to disallow as repairs items costing more than $5.00, notwithstanding that the cost of the disallowed item was a necessary expenditure to maintain the equipment in operating condition.

The plaintiff deducted the cost of repairs as an expense; of $20,000.00 for the year 1924, of $15,031.89 for the year 1925, of $9,531.81 for the year 1926, of $6,014.33 for the year 1927 and of $3,777.22 for the year 1928. The Commissioner determined the said amounts to be the cost of replacements of property no longer servicable, disallowed the deductions thereof as repairs, charged them to reserve for depreciation, and made no allowances for depreciation thereon. All of the said amounts that were deducted and disallowed as an expense were the costs of replacing component parts of either machinery or equipment that is subject to depreciation and with respect to which a reserve for depreciation has been set up reflecting at all times the aggregate of allowances made theretofore for depreciation

thereof. Art. 166, Reg. 62. The reserve for depreciation, with respect to any individual machine is not complete until the amount of the reserve has become equal to either the original cost or the fair market value of that machine, whichever was correctly used as a basis for computing the allowances for depreciation thereon, as provided in Art. 161, Reg. 62. In charging the cost of replacing a component part of a machine to the reserve for depreciation, the Commissioner, in effect, admits that the cost of the item being replaced is being taken out of both the capital and reserve for depreciation accounts as having been either fully depreciated or as being no longer useful. But, since the Commissioner has not determined that the machine was fully depreciated, it follows that the component part thereof being replaced has not been fully depreciated. The amount of the aggregate allowances for depreciation on the replaced part contained in the reserve for depreciation is proportionately no more than for the machine as a whole of which the replacement is a component part. Therefore, by charging the replacement cost to reserve for depreciation, the Commissioner eliminates the cost thereof from both the capital and reserve accounts, leaving the plaintiff in the position of sustaining a loss in the amount of the undepreciated cost of the part replaced, with respect to which, the Commissioner will not allow any further depreciation, whereas, the plaintiff is entitled to a deduction of such loss as provided in section 234 (a) (1). The said amounts were cost of incidental repairs and were properly deducted as ordinary and necessary expenses incidental to the operations of the plaintiff's equipment. Art. 103, Reg. 62 provides that, "the cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be conducted as expense * * *" Sec. 234 (a) (1), Rev. Act of 1921, and similarly the subsequent revenue acts, provides for the deduction from gross income of all ordinary and necessary expenses including the cost of re-

pairs. Art. 162, Reg. 62, provides that, "Property kept in repair may nevertheless, be the subject of a depreciation allowance". This Court should take judicial cognizance of the fact that repairs are an ordinary and necessary procedure and expense in the operation of any property. The said repairs were incidental, did not add to the original value or prolong the life of the property, and were made for the purpose of maintaining the property in an ordinarily efficient operating condition as originally contemplated, as testified by the plaintiff's witnesses. Upon being asked whether any of the items, the cost of which were debited to reserve for depreciation, extended the life of the property, Mr. Arrington, a witness for the plaintiff, remembering that the revenue agent was willing to allow as repairs only small expenditures, testified, "my feeling is that—it was just simply a case of up-keep, and I think that belting item is a good sample of it. The size of the belting does not make any difference as far as I can see. A 10-inch belt, I do not see that it increases the life any more than a 4-inch belt." (R. 95) Mr. Gregory, General Manager of the plaintiff's plant, being asked as to the purpose of such expenditures as made for the years 1927 and 1928, testified they were made, "in order to keep the existing machinery in operation", and such repairs are made from time to time (R. 119) and unless such repairs were made the machinery would not have done good work (R. 120-124) and that the parts of some machines needed to be replaced more often than others, depending upon the circumstances (R. 121-124). The aforesaid testimony was from practical men who are experts in the matters of which they testified. One thereof, Mr. Arrington, treasurer of the plaintiff, spent all of his adult life in the plaintiff's plant, in an official capacity. Mr. Gregory, the other witness, was employed as the General Manager, supervising operations, including maintenance and repairs. His employment as General Manager of a multi-million dollar concern, stamps him as an expert in that capacity and fully qualified to state his

opinion as well as the facts. Certainly the plaintiff and its witnesses are better qualified to know and to state the purpose of the repairs in question and to state whether they were in fact repairs or improvements. An examination of the lists and descriptions of items of which the costs were disallowed for the years 1924, 1925 and 1926 (Jt. Ex. M-1), shows them to be of the same nature as those disallowed for the years 1927 and 1928 (R. 118-124) and the effect of the testimony of the witness, Mr. Gregory, coupled with the determination of the plaintiff that they were repairs, indicates that the costs disallowed by the Commissioner as repairs for the years 1924, 1925 and 1926 were properly deducted as expenses for repairs. In fact, the trial court allowed the plaintiff judgment for the year 1926 upon the basis of its holding that the disallowed items for the year 1926 were in fact repairs. The court did not hold that the disallowed repairs for any of the years were not in fact repairs properly chargeable to expense. The Commissioner's determinations with respect to disallowances of deductions taken for the cost of repairs appear to be arbitrary and without rational foundation, and can no longer be presumed to be correct (*Russell* v. *Comm., supra*) and should be set aside. *Helvering* v. *Taylor, supra.*

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 8. In deciding that the Commissioner properly disallowed deductions claimed for the petitioner's liability to pay additional taxes to the state of South Carolina for each of the years 1926, 1927, and 1928.

Pursuant to sections 1, 2, and 3 of an Act to Raise Revenue enacted by the General Assembly of the State of South Carolina, infra, R. 16, 17, the petitioner became liable for the payment of additional taxes to the State of South Carolina, in the amounts claimed, as set forth, in the claims for refund and the complaint, the deduction for which, the Commissioner disallowed, and the Court erred in deciding

that such deductions were properly disallowed, the petitioner having kept its books and rendered its returns on an accrual basis.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 9. In deciding that the Commissioner properly disallowed the petitioner's claimed deductions, for the years 1923, 1924, and 1925, in the amounts of the excess over the cost or market value, which ever is lower, of the accounts and notes receivable as of the close of each of the respective years, and that such accounts and notes receivable are not part of the petitioner's inventory.

The Court should take judicial cognizance of the well known fact; that accounts receivable and notes receivable are necessarily the results of a well-established trade and commercial practice in the selling of goods and services, in the granting of credit to purchasers and/or in the allowances of certain discounts upon receipt of payment for goods within thirty, sixty and ninety days, without requiring notes from the purchasers; that banks will not purchase accounts receivable, and when considering them in financial statements for loan purposes, will generally value them at not more than seventy-five per cent of their face value; that the market value of an account receivable is that price at which the owner and the prospective purchaser thereof, neither being forced to buy or sell, will agree upon, which value is generally considerably less than the face value thereof; that if their market value would be as much as their face value, most business concerns would promptly and currently sell their accounts receivable in order to obtain and maintain a larger amount of working capital, and they would not have accounts receivable remaining on hand at the end of the year; that when accounts receivable are transformed into notes receivable, a more negotiable form, the banks will sometimes buy the best thereof at discounts ranging from fifteen to twenty-five percent, and refuse to

buy the remainder; that the automobile sales financing organizations, which have been set up for the special purpose of purchasing the notes receivable of the automobile sales agencies, will purchase the best of the notes receivable at discounts ranging from 15 to 25% of their face value and refuse to buy or finance such notes as they deem to be poor risks; that a note receivable will generally have a market value greatly in excess of the market value of an account receivable of the same face value; that the original holder of an account receivable has parted with the goods, in return for which, he is not in constructive receipt of any part of the face value, either the cost of the goods or the expectant profit, and he may sustain a loss of the entire amount. Therefore, an account receivable, as of the close of any year, is not income in that year, but is income at some future time when and if the purchaser pays for the goods.

Gain and profits only are taxable (Sections 213, 214, 232, 234, Rev. Act of 1921, and similarly in subsequent acts for the years in which they were constructively received (Art. 50, Reg. 69), but are constructively received only when made payable to the taxpayer without substantial limitation or restriction as to the time or the manner of payment. Art. 51, Reg. 69. With respect to the accounts receivable, as of the close of the years 1923, 1924 and 1925, the taxpayer was neither in receipt, or in constructive receipt of any part thereof until the following year when no longer limited or restricted in making demand for immediate payment thereof. Therefore, the Commissioner erred in determining that the taxpayer received taxable income in either of the said years with respect to the accounts receivable, as of the close thereof, and in assessing a tax thereon.

In its balance sheets, the taxpayer-appellant reported its accounts receivable, as of the close of the years 1923, 1924 and 1925, at their face value, at $246,395.18, $434,098.77, and $702,924.06, respectively, whereas, the said accounts receivable should have been reported at cost or market,

which ever is lower, the same basis of valuation at which the other property was reported therein, with the exception of notes receivable which were also erroneously reported at face value. Cash was reported at cost and market, both being the same as the face value thereof. Plant account was reported at cost, less depreciation, the lowest market value it could have, since the plaintiff is a going concern. In the case of *Henry L. Russell* v. *Comm.*, 45 F. (2d), 100 (U. S. C. A. 1), it was held that the balance sheet is an inventory in which all of the assets are to be valued at cost or market, which ever is lower, in accordance with Art. 1612 of Reg. 69.

The Commissioner determined the taxpayer's net income or net profit, for the year 1923, to be $381,801.89 (Jt. Exs. B and D), with respect to gross income of $861,213.86 (Jt. Ex. "A"), therefore, expressed in percentage, the cost of the accounts receivable, as of the close of 1923, was .5567%, or $137,168.20, and the expectant profit portion thereof was .4433%, or $109,226.98. Therefore, the net and taxable income, for the year 1923, was erroneously determined by the Commissioner to include $109,226.98, since that amount is either the excess valuation of the account receivable as inventory or is the expectant but unrealized profit in that year, or both.

This Court should take judicial cognizance of the well known fact that balance sheets are necessarily used by all businesses and taxpayers who keep their accounts on the accrual basis. That the Commissioner proposed and expected such taxpayers should report in their balance sheets their accounts receivable at cost or market, which ever is lower, is clearly shown by Articles 151 and 1612 promulgated by him in accordance with section 205, Rev. Act of 1926. The conclusion is inescapable that, in the determination of the taxpayers net income for the years 1923, 1924 and 1925, the Commissioner erroneously included the accounts receivable at values in excess of cost, if inventory, and at any values whatever, if not inventory, since the

taxpayer was not in constructive receipt in those years of any portion thereof, not even the cost.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 10. In failing to decide that this action for refund of money belonging to the petitioner, illegally exacted and retained by the respondent, is equitable in nature, requires equitable consideration and relief and the setting aside of defenses of a technical nature, and that the remedy provided at law has not been adequate, having not provided recovery, cessation of the Commissioner's continuous illegal exactions of excessive taxes, and having not prevented contradictory decisions of the courts in support of the Commissioners erroneous determinations and the respondent's continuous and illegal possession of the petitioner's property.

This action was brought for the refund of moneys, allegedly overpaid as taxes, belonging to the plaintiff, and illegally and wrongfully obtained and held by the defendant, for the years in suit. The inadequacy of deductions taken and allowances made for depreciation is chiefly the cause of the overpayments in taxes sued for, and arises from a long standing erroneous practice of the Commissioner with respect to the property herein. With the exception of additions to property acquired after June 30, 1922, all of the property subject to depreciation, for the years in suit, was acquired by the plaintiff, on June 30, 1922, from its predecessor in business. In 1914, the Commissioner determined the cost of the property, as of December 31, 1914, to be only in the amount of the depreciated cost as of that date, and he required the predecessor to take its deductions for depreciation, for all years subsequent thereto, on such erroneously determined cost basis, notwithstanding that, under section 234 (a) (7), Rev. Act of 1921, as similarly provided in subsequent revenue acts with respect to such part of its property as was acquired prior to March 1, 1913, the predecessor was entitled to take and to be allowed de-

ductions for depreciation on the basis of the fair market value thereof as of March 1, 1913. Claims for refund of taxes overpaid by the predecessor, on such basis, were rejected by the Commissioner. Although having acquired the predecessor's property, on June 30, 1922, the plaintiff was required by the Commissioner to take its deductions for depreciation on the same cost basis which he had required the predecessor to use.

The plaintiff duly filed claims for refund, for each of the years in suit, (R. 53-75) setting forth, as one of the grounds therefor, that the deductions taken and the allowances made for depreciation were inadequate, and that the allowances for depreciation should have been but was not based on the fair market value of the property as of the basic date. Although, being fully aware of the provisions of the taxing statutes that, with respect to property acquired before March 1, 1913, the basis for depreciation allowances shall be based on the fair market value as of March 1, 1913, and that such fair market value was in excess of the basis on which he had allowed depreciation, the Commissioner rejected the said claims. Furthermore, the Commissioner has continued requiring the plaintiff to deduct depreciation on the same basis as the cost used by the predecessor, for the years subsequent to the years in suit. The plaintiff took the deductions as required and overpaid the tax under protest, attaching to the return a copy of its letter, dated June 26, 1931, Jt. Ex. G, (R. 146) calling attention to the claims for refund that the taxpayer had filed with respect to the taxes it had overpaid. (Jt. Ex. X.) on a similar basis.

As the Commissioner continues to require that the plaintiff use the same cost as was used by its predecessor as a basis for its deductions for depreciation, and continuously refuses to refund the taxes overpaid on such basis, the conclusion is unavoidable that he will continue such illegal and wrongful exactions of excessive taxes, until and unless this Court causes a judgment to be rendered in favor of the

plaintiff. Therefore, this action is equitable in nature and requires equitable consideration. *Walla Walla* v. *W. W.*, 172 U. S., 1.

The plaintiff's claims for refund were filed under the provisions of Section 252, Revenue Act of 1921, and similar provisions of subsequent revenue acts. This suit was brought thereon under the provisions of Section 24 (20th) of the Judicial Code. A remedy having been provided in law, this action was necessarily brought as an action at law, even though it is equitable in nature (*Big Diamond Mills* v. *U. S.*, 51 F. (2d), 721; *Aetna L. Ins. Co.* v. *Middleport*, 124 U. S., 534) and brings within its range whatever facts reside in the domain of equity and conscience (*U. S.* v. *Factors & Finance*, 288 U. S., 89) which, however, does not deprive the equity court of jurisdition (*U. S.* v. *Howland*, 17 U. S., 108), the trial court having concurrent jurisdiction in equity and law. *Armstrong* v. *Athens Co.*, 41 U. S., 281. As this action is equitable in nature, technicalities, such as are relied upon by the defendant, should not be permitted to thwart conscionable consideration and the equitable relief prayed for in the petition.

It has been held that, where otherwise there was a plain, adequate and complete remedy at law, but that the basis of the action for recovery was of a continuing nature and a rescission of a fraudulent contract or a restraining order was necessary for complete relief, in addition to the damages sought, then the judgment at law is not adopted to the end in view, and equity will take jurisdiction. *Thompson* v. *Allen*, 115 U. S. 554; *Buzard* v. *Houston*, 119 U. S. 352. A remedy at law is not adequate, and not as prompt and efficient as in equity, where it depends on the will of the opposing party, as in this case depending on the will of the Commissioner, whose determinations are presumed to be correct although shown to be clearly contrary to the provisions of law. *Brown* v. *Pac. Mut. Life Ins. Co.* (C. C. A. 4th) 62 F. (2d) 711; *N. W. Mut. Life Ins. Co* v. *Wiggins*, 15 F. (2d) 646, Cert. Dnd. 273 U. S. 746; *Schwartz* v. *Northern L. Ins. Co.*, 25 F. (2d) 555, Cert. dnd, 278 U. S. 628.

A remedy at law does not exist where a multiplicity of actions are required to obtain adequate relief. *Oelrichs* v. *Spain*, 15 Wall. 227; *Mut. L. Ins.* v. *Blair*, 130 Fed. 971; *Mills* v. *Chicago*, 127 Fed. 735, and innumerable others.

The Fourteenth Amendment applies to every person who is a repository of authority of his acts done under guise of such authority, but in excess thereof. *Home Tel. & Tel. Co.* v. *Los Angeles*, 227 U. S. 278; *Fidelity & D. Co.* v. *Tafoya*, 270 U. S. 426. Unconstitutionality may be shown by things judicially noticed or by facts established by evidence. *Weaver* v. *Palmer Bros. Co.*, 270 U. S. 402.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 11. In deciding that the general traverse filed by the defendant—respondent in this action, complied with the requirements of law and equity in answer to the complaint, that the trial court properly granted the defendant leave, in June 1940, to amend its general traverse and to raise new issues in its defense, and properly denied the petitioners motions, (a) to revoke that court's order that granted the defendant leave to amend its general traverse, (b) to strike the general traverse from the record, and (c) to strike the amendment to the general traverse from the record.

This action was brought, on October 23, 1933, under the provisions of Section 24 (20th) of the Judicial Code, for the refund of taxes overpaid under protest, for the years 1923 to 1928, inclusive. The action is equitable in nature, as hereinafter shown. No answer was ever filed. On December 20, 1933, the defendant, appellee here, filed its general traverse. (R. 52) The general traverse did not meet either legal or procedural requirements. *Farmers L. Lt. Co.* v. *Miller*, 298 Fed., 758; *Shera* v. *M. L. Lt. Co.*, 237 Fed., 484. It was filed when the Act of March 3, 1915, was in force, providing that, in actions at law, equitable defenses can be pleaded by answer, plea or replication (*Liberty Oil Co.* v. *Condon Nat'l Bank*, 260 U. S., 235) permitting a plaintiff to plead an equitable reply to a legal de-

fense set up in an action at law (*Plews* v. *Burrage,* 274 F., 881; *Stanley* v. *U. S.,* 37 F. (2d), 188) and providing that equitable and legal issues can be determined in a single suit. *Whitney Co.* v. *Johnson,* 14 F. (2d), 24.

This action being equitable in nature, the general traverse was barred by Rule 30 of Practice in Equity, since it was not responsive and did not specifically admit or deny any of the averments in the complaint. Where, as in this case, the defendant must deny under oath the execution of a written instrument, the foundation of the action for defense, the denial shop be specific, and a general denial is not specific (*Banks* v. *McCosker,* 34 A., 539) and when not specifically denied, it is deemed to be admitted. *Anderson* v. *Blair,* 48 S. E., 951.

Under the Conformity Act, in effect when the said general traverse was filed, the Federal Courts were required to conform to the order of pleading in the State court (*Robert* v. *Lewis,* 144 U. S., 656; *Southern Pac. Co.* v. *Denton,* 146 U. S., 209) and where a defense of any character is required to be pled specifically, by the State Code, or rule, it was required to be pled specially in the Federal Court. *Groton Bridge & Mfg. Co.* v. *Amer. Bridge Co.,* 151 F., 879; *Hardy* v. *Chicago, St. P., M & O. R. Co.,* 172 F., 454. The effect given to the general issue by the State Code will be followed by the Federal Courts. *Burley* v. *German Amer. Bank,* 111 U. S., 221; *Roberts* v. *Lewis, supra.* Failure of the defendant to file specific denials within 60 days after the complaint was filed, whether equitable or in law, operates as an admission of the facts alleged in the complaint (*Howard* v. *Glenn,* 11 So., 610; *Alderman* v. *French,* 1 Pick., 1) and where the plaintiff sufficiently stated a cause of action, such failure subjects the defendant to judgment by default (*Van Ingen* v. *Berger,* 92 N. E., 433; *Atchison, T. & S. F.* v. *Lambert,* 121 P., 654) and terminates the defendant's right to participate in the litigation. The trial court erred in permitting the defendant to participate in the litigation in this case, and in failing to grant the plain-

tiff's motion to prevent such participation by the defendant.

The trial court, in this action, is located in Greenville, South Carolina. At the time the answer was due, Sec. 457 of the 1932 Code of South Carolina was in effect, under which it was held that a general denial does not put in issue allegations contained in the complaint (*Montgomery* v. *Seaboard Air Line Ry.*, 73 S. C., 503; *Land Mtg. Invt.* v. *Williams*, 35 S. C., 367) that the defendant is limited to either a demurrer or answer; that if a demurrer is duly filed in good faith and thereafter overruled, the defendant may be allowed to answer; that it is improper to demur and answer at the same time (*Sprunt* v. *Gordon*, 89 S. C., 426) that failure to demur, when proper, waives the objections that were demurrable (*Daniels* v. *Moses*, 12 S. C., 130) and such objections as would have formed a basis for demurrer came too late after failure to make it by demurrer (*Featherstone* v. *Norris*, 7 S. C., 472; *Evans* v. *McLucas*, 12 S. C., 56; *Daniels* v. *Moses*, 12 S. C., 130; *Ross* v. *Lindler*, 12 S. C., 592) and that a pleading on the merits waived all other objections. *Jenkins* v. *A. C. L. Ry.*, 84 S. C., 343. Under the Conformity Act and the South Carolina law, the general traverse did not constitute an answer, and application to amend it by setting up demurrable objections, after the 60-day period for filing an answer had expired, was too late and otherwise not permissible.

This action was brought under the Tucker Act, 24 Stat., 505, of which Sec. 6 provides, "It shall be the duty of the District Attorney * * * to file a plea, answer, or demurrer on the part of the Government." It was necessary for the District Attorney to make an election, since he was not permitted to file more than one of the three. In an action brought under the Tucker Act and where a general traverse was filed and ordered stricken by the trial Court, the appellate court, in approving, in approving such act by the trial court, stated "The rule required the affidavit not only to deny the right of the plaintiff but to state also in precise and distinct terms the grounds of defense which

must be such as would, if true, be sufficient to defeat the plaintiff's claim in whole or in part", and that under the Conformity Act the law and procedure of the State may govern when not inconsistent with the Federal law. *Fidelity & Deposit Co.* v. *U. S.*, 187 U. S., 315. The general traverse is not a defense under the Tucker Act. *U. S.* v. *Lindholm*, 79 F. (2d), 784, *citing, Hoff* v. *St. Paul-Mercury Indemn. Co.*, 74 F. (2d), 689; *Maryland Gas Co.* v. *Sparks*, 76 F. (2d), 929.

Having failed to demur within 60 days after the complaint was filed, the appellee was barred by law from making a plea thereafter of such matters as statute of limitations, estoppel, or *res judicata. Gormley* v. *Bunyon*, 138 U. S., 623.

Although the complaint contains six causes of action, a separate cause for each of the years 1923 to 1928, inclusive, and 74 numbered paragraphs alleging facts, figures and records of transactions that occurred between appellant and appellee, the District Attorney brushed it aside with the wave of the hand and filed a one-paragraph general traverse, stating that the defendant "has not sufficient information upon which to form a belief—therefore, denies each and every allegation." The general denial is not only illegal, but is false, frivolous, evasive and sham. Its falsity is proven by the numerous admissions of appellee thereafter set forth in the alleged amended answer, the pre-trial findings and by the numerous documents obtained from the defendant's records and submitted in evidence at the trial. Of every fact alleged, the appellee had maintained a complete record. The existence of complete records in the hands of the appellee of all transactions between the Commissioner and the taxpayer, with respect to the taxpayer's tax liability, is a matter of public knowledge, of which judicial cognizance should be taken. In line with his duty, the District Attorney had knowledge of the existence and location of the record maintained by the defendant, with respect to the plaintiff's tax matters, had access thereto, and was required to acquaint himself sufficiently with

the facts therein to prepare and file an answer to the plaintiff's petition arising therefrom. Denials of information sufficient to form a belief relating to matters of public records are presumably frivolous. *Harley* v. *Plant,* 210 N. Y., 405; *Kirschbaum* v. *Eschman,* 205 N. Y., 127; *Buller* v. *Sidell,* 43 F., 116; *Dahlstrom* v. *Germunder,* 198 N. Y., 449; *N. German Lloyd* v. *Elting,* 43 F. (2d), 203; *Lloyd Sebando, etc.,* v. *Elting,* 46 F. (2d), 315. The defendant having complete and detailed information respecting all matters alleged in the complaint, its assertions of ignorance thereof in its general traverse is plainly false, and the general traverse should have been stricken from the record. *Ice Plant Equipment Co.* v. *Martocello,* 43 F. Supp., 281; *Reed* v. *Turner,* 2 F. R. D., 92; *Neiman* v. *Beth. Nat'l Bank,* 32 F. Supp., 436; *Neiman* v. *Long,* 31 F. Supp., 30; *Neiman* v. *Saltis,* 24 F. Supp., 1014. A general denial of allegations in a pleading of matters of record, or of written instruments to which the defendant is a party, or of knowledge of matters of which the defendant might have informed himself by reasonable diligence will be stricken out on a motion as sham or frivolous (*Kline* v. *Harris,* 30 N. Dak., 421; *Oregonian R. Co.* v. *Oregon Ry., etc.,* 22 F., 245; *Sloan* v. *So. Cal. R. Co.,* 44 P., 320; *Barrie* v. *Yorston,* 54 N. Y. S., 841; *Rochkind* v. *Pearlman,* 108 N. Y. S., 224; *Sharp* v. *Sharp,* 145 N. Y. S., 386; *Slater* v. *Maxwell,* 73 U. S., 268) and the trial court erred in failing to grant the plaintiff's motion to strike the general traverse. Even if the general traverse should otherwise be held to be good in form, it is sham, since it is false, in fact, the words "false" and "sham", being synonymous. *Piercy* v. *Sabin,* 10 Cal., 22; *Cunha* v. *Angle Cal. Nat'l Bank,* 93 P. (2d), 572; *Saltis* v. *Reilly,* 147 A., 778; *People* v. *McCumber,* 18 N. Y., 315; *State* v. *Thompson,* 199 P., 161.

The general traverse did not face the facts, raise anything in issue, or present any defense (*State ex rel Englehard* v. *Weber,* 105 N. W., 490; *Fidelity L. Ins. Co.* v. *Wilkes Barre & H. R. Co.,* 120 A. 734), and does not form or tender any material issue. *Hayward* v. *Grant,* 13 Minn. 165; *People* v. *McComber, supra.* Because of its inherent power the

court has authority to strike sham or frivolous pleas from the record (*U. S.* v. *Dashiel,* 71 U. S., 182; *Piercy* v. *Sabin, supra; Patrick* v. *Mams,* 28 P. 90; *Rhea* v. *Hackney,* 157 So., 190; *Clark* v. *Life & C. Ins. Co.,* 53 S. W. (2d), 968), and, having such power, the trial court erred in granting the defendant leave to amend such sham and frivolous general traverse, and in failing to grant the plaintiff's motions to vacate the order of the court granting the defendant leave to amend the general traverse, to strike both the general traverse and the document, purporting to amend it, from the record, to prevent the defendant from participating in the proceedings and trial, and for summary judgment for the plaintiff.

Furthermore, the defendant is estopped from making any contention in either an original or an amended answer, in this action, that the claims for refund were barred by the statute of limitations, since such contention is contrary to the determinations of the Commissioner. The Commissioner considered all of the plaintiff's claims for refund on their merit, which he would not have done if the claims were barred by statute of limitations. His consideration of the claims on their merit was the Commissioner's determination that the claims were not barred by the statute of limitations. The defendant did not allege or charge that the Commissioner committed fraud or mistake. The determination of the Commissioner is prima facie correct (*Anchor Co. Inc.* v. *Comm.,* 42 F. (2d), 99; *Gloyd* v. *Comm.,* 63 F. (2d), 649) and his decision in favor of a taxpayer claimant, in the absence of fraud or mistake, is an award all sufficient for the foundation of a judgment. *Woolner* v. *U. S.,* 13 Ct. Cls., 355; *Sybrant et al* v. *U. S.,* 19 Ct. Cls., 461; *U. S.* v. *Factors & Finance,* 288 U. S. 89, 96.

The general traverse, having brought nothing into issue, is not subject to amendment. Had there been anything to amend, the attempt began too late. The trial court clearly erred and abused its discretionary power in granting the appellee leave to amend its general traverse, on June 26, 1940, nearly seven years after the answer was due.

In a case where the defendant was much more diligent in requesting leave to amend its general traverse, the trial judge refused. The appellate court in approving the action of the trial judge stated, "the original answer filed a year before the trial did not deny the allegations—was a confession they were true—the answer might have been amended by leave of the court or judge upon reasonable notice—if justice so required. No such notice was given of the amendment or that justice required it. Justice did not require it. —the court did not abuse its discretion in refusing the defendant leave." *Montgomery* v. *Pac. Elec. Ry. Co.*, 293 F., 682. Had the appellee anything to amend, it was grossly negligent and guilty of laches in failing to request leave to amend about seven years earlier.

The trial judge erred in granting leave to amend the appellee's general traverse on an *ex parte* application. Appellant had no knowledge of the application until after having been advised of the filing of the alleged amended answer. "A court can make no decree affecting the rights of an absent person and can make no decree between the parties before it, which so far involves or depends upon the rights of an absent person, that complete and final justice cannot be done between the parties to the suit without affecting those rights." *State of Washington* v. *U. S.*, 87 F. (2d), 421; *Shields* v. *Barrow*, 58 U. S., 130.

Under Rule 6 (b) F. R. C. P., in effect at the time when the defendant applied for leave of the court to amend its general traverse the application for such leave to amend was made too late, having not been made within 60 days after the complaint was filed, unless the defendant could show good cause or excusable neglect for having delayed such application until about 6½ years after the 60 day period for filing an answer had expired. In view of the fact that the defendant had sufficient knowledge of the facts alleged in the complaint to have been able to file an answer within the period prescribed therefor, but, notwithstanding, it filed a general traverse which is sham, evasive and frivolous, an inexcusable thing to have done under the circum-

stances, it does not appear possible for the defendant to have shown either good cause or excusable neglect for such excessively late application.

The document entitled, "Amendment to Defendant's answer setting up certain further and separate defenses," and immediately filed upon the signature of the trial judge to an order granting leave to amend, appears to be a substitution instead of an amendment. Its purpose appears to have been, for the first time, to raise issues and to set up separate and affirmative defenses, since it has been shown hereinbefore that the general traverse raised no issue or defense and could not be amended. An amendment presupposes a change in something existing, not a substitute of something else for that which does not legally exist. *Cooke* v. *Meyers,* 282 P., 1114. Under the guise of an amendment to its general traverse, the defendant substituted a document setting up affirmative defenses and new causes of action, and since the application for leave to amend the general traverse was not made until about 6½ years after the prescribed period for the filing of an answer had expired, the proposed amendment is barred by the statute of limitations. *B & O. S. W. R. Co.* v. *Carroll,* 280 U. S., 491; *Seaboard A. L. R.* v. *Renn,* 241 U. S., 290.

From the foregoing it appears that neither an answer or an amendment of an answer has ever been filed by the defendant in this action; that all of the averments in the complaint stand as admitted by the defendant, and that the trial court erred in failing to grant the plaintiff's motion for summary judgment for the plaintiff.

On September 18, 1940, the plaintiff filed, with the trial court, its motions to revoke the order that granted the defendant leave to amend its general traverse, to strike both the general traverse and the purported amended answer, to bar the defendant from participation in the trial and proceedings of the action, and for summary in favor of the plaintiff. The plaintiff also filed affidavits and briefs in support of its motions, setting forth the facts and errors, argument and citations of law (R. 75-77) which are incor-

porated as a part hereof as if restated here, fully supporting this point.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 12. In deciding that the trial judge did not abuse his power of judicial discretion in denying the petitioner's motion for relief, applied for under Rule 60 (b) of the Federal Rules of Civil Procedure, submitting newly discovered evidence.

On November 27, 1948, after the period prescribed for making application for a new trial had expired, the plaintiff's motion, under Rule 60 (b) Federal Rules of Civil Procedure, was filed and entered, requesting relief from that part of the judgment, entered July 21, 1948, dismissing the petition. Attached to the motion papers was an affidavit in support thereof, alleging that new evidence had just been discovered by counsel for the plaintiff, of which counsel had no prior knowledge, and which the plaintiff had not recognized as being pertinent, that, in June, 1947, all of the plaintiff's outstanding capital stock, consisting of 11,134 shares of a par value of $100.00 per share, were sold to new interests at a price of $764.69 per share, and further alleging that the new evidence, if introduced, would substantiate the claim of the plaintiff and sustain the testimony of the plaintiff's witnesses, given at the trial, that the fair market value of the said property, on March 1, 1913, and on June 30, 1922, is greatly in excess of the book record of cost as of those dates.

The motion met the requirements of Rule 60(b) F. R. C. P. infra, both as to timeliness and grounds. The plaintiff's failure to recognize any value as evidence and to advise counsel of the sale of the capital stock is excusable, being in the same position of an owner of land, knowing that he is the owner of the mineral rights covered, but not realizing that his rights included a rich deposit of oil in commercial quantity, until others drilled an oil well on his property. The Revenue Acts all provide that depletion of

such oil is based on the date of discovery which date is when the oil well came in. It appears that the date of discovery, in this case, is when accidently counsel learned of the sale of the said stock and advised the plaintiff of the value of such fact as evidence. Even though the plaintiff knew of the sale of its stock, its neglect in advising counsel is excusable. And as "the court may relieve a party or his legal representative", it appears that counsel, like the driller of the oil well, made his discovery when he first learned of it, which was immediately preceding the filing of the motion.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 13. In deciding that the trial court properly denied the petitioner's motion for summary judgment, notwithstanding that the defendant did not file an answer and offered nothing but technical defenses.

As the defendant-respondent failed to file any answer, offered nothing but technical defenses, failed to refute the facts and claims alleged by the petitioner, and as the record clearly showed that the petitioner was entitled to judgment, the court erred in denying the petitioner's motion for summary judgment.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 14. In deciding that any of the petitioner's claims for refund or any part thereof, for any of the years in suit, are barred by the statute of limitations, and
>
> 15. In deciding that this action is barred by the statute of limitations with to the original claims for refund filed for the years in suit.

The court erred in assuming that the Commissioner is authorized by law to reject a claim for refund on its merits, and in failing to recognize the difference between a failure of the Commissioner either to convince the taxpayer that its claim is baseless and should not prevail or to arrive

at a justifiable compromise, and, a notice in writing by the Commissioner to the effect that he refuses to consider the claim any further, and, that the taxpayer may consider the claim to be permanently rejected as of a certain date, notwithstanding that he is under compulsion to continuously entertain further presentments of the claimant in support of it's claim and determine the correct amount of the tax. The court also erred in failing to determine that invalidity of a claim, such as being barred by the statute of limitations, or some other technical ground that could not be cured, is the only reasonable ground that might be considered, under the law, as a basis for a rejection and a notice thereof to be sent by the Commissioner, since further consideration or an allowance therefor would result in no benefit to the claimant.

This action is based on claims for refund that were duly filed and amended, by appellant, for each of the years 1923 to 1928, inclusive, and was brought within two years after the final rejection by the Commissioner of the said claims as amended. The action was duly brought, with respect to the claims as amended for the years 1923 to 1926, inclusive, and for the years 1927 and 1928 as originally filed, and is not barred by the statute of limitations. Appellant filed an original claim for refund; for the year 1923 on June 11, 1928; for each of the years 1924 and 1925 on May 16, 1929; for the year 1926 on December 2, 1929; and for each of the years 1927 and 1928 on April 25, 1931, and, thereafter, amended the claims for 1926 and prior years in suit. Pre-trial Findings of Fact, R. 53-75) Ex. O and Joint Ex. C, F, G, N, N-1, O and Q-1.

On October 23, 1931, the Commissioner finally rejected all of the appellants claims for refund as originally filed for the years 1927 and 1928 and as amended for the earlier years. (R. 53-75). The Commissioner considered and treated all claims filed subsequent to the original claim for each of the years 1923 to 1926, inclusive, as amendments of the original claim, (P. T. F., Part II, Pars., g. j, and n; Part III, Pars., e, n, n-1, r, s, t, x and y; Part IV, Pars., b

and e; Part V, Pars., b, c, and e; and Joint Exs., R, S, and T.) and he rejected the claims on their merit and not because of the statute of limitations. (Jt. Ex. H.) Par., m, P.T.F. (R. 180). As is his custom the Commissioner first determines whether the claim is barred by the statute of limitations, since, if so barred, nothing would be gained by considering the claim on the merits. If the Commissioner found that any of the claims were barred by the Statute of Limitations, he waived such irregularity as he had a right to do. *Tucker* v. *Alexander,* 275 U. S., 228. The Commissioners letters to appellant shows that he determined that the appellant had kept its claims open and duly amended, Pars., N, O, P, Q, 5, S-1, T and V, P, T. F. (R. 60-72). The Commissioners determination is *prima facie* correct (*Anchor Co.* v. *Comm.,* 42 F. (2d), 99; *Gloyd* v. *Comm.,* 63 F. (2d), 649) and are presumed to be correct, and the burden of proof rests on him who contends that the Commissioner erred (*Lukas* v. *Structural Steel,* 281 U. S., 264; *Wickwire* v. *Reinecke,* 275 U. S., 101; *Welch* v. *Helvering,* 290 U. S., 111) and his decision in favor of the taxpayer, in the absence of fraud or mistake, is an award all sufficient for the foundation of a judgment. *Woolner* v. *U. S.,* 13 Ct. Cls., 355; *Sybrant et al.* v. *U. S.* 19 Ct. Cls., 461, *U. S.* v. *Factors & Finance Co., supra.* The respondent did not meet the burden resting on it to prove and the court did not decide that the Commissioner erred in repeatedly reconsidering and/or reopening the petitioner's claims after having sent notices of their rejection. In a former action, for the year 1918, involving the predecessor the taxpayer therein, although holding that it lacked jurisdiction, because the claims for refund were barred by statute of limitations, or otherwise defective, the same trial court, as in this action, granted this appellant judgment in an amount previously allowed by the Commissioner but not yet refunded (*Union Bleachery* v. *U. S.,* 15 A. F. T. R., 871; 79 F. (2d), 549.

No provision appears to have been made by either statute or regulation as to whether amendments to the original

claims should be either formal or informal. Some of appellants amendments, consisted of letters, and some of brief under oath, setting forth additional facts and theories in support of the original claims for refund. To be on the safe side, occasionally the statements under oath were attached to a Form 843, setting forth that the matter is in support of the original claim for refund. P. T. F., Exhibits F, G, N, O, Q, Q-1 and U-2. That the Commissioner accepted, treated and determined all claims, filed subsequent to the filing of the original claims, to be amendments to the original claims for refund is shown by his comment in the record. P. T. F., Pars. n, n-1, s, s-1, t and v. (R. 60-75.) Consequently, the final objection, by the Commissioner, on October 23, 1931, was with respect to appellants original claims for refund as theretofore amended since the rejection was on the merits, and the Commissioner did not determine that any of the original claims had not been duly amended. The Commissioners determination that appellant's claims, for 1926 and each prior year in suit, were duly amended is *prima facie* correct (*Anchor Co.* v. *Comm., supra; Gloyd* v. *Comm., supra*) and is presumed to be correct, and the burden rests on him who contends that the Commissioner erred in that regard. *Lucas* v. *Structural Steel, supra.*

The function of a claim for refund on Form 843 is to formally notify the Commissioner, that for a certain year, the taxpayer had paid more tax than is required by law. "The claim in its original form is one for money had and received to the use of the appellee after the manner of the common counts in a suit at a common law—it charges overpayment generally, and thus brings within its range whatever facts reside in the domain of equity and conscience," (*U. S.* v. *Factors & Finance,* 288 U. S. 94) and until, it is agreed between the taxpayer and the Commissioner that, the taxpayer cannot furnish sufficient facts to prove overpayment, the claim should not be rejected. The ultimate question presented for decision upon a claim for refund is whether the taxpayer has overpaid his tax. This involves

a determination of the entire tax liability." *Lewis* v. *Reynolds*, 284 U. S. 281. "A revision for error of fact or law—may be made by the Commissioner on his own motion, and indeed is commonly so made, for it is incidental to his general duty to audit the accounts." *U. S.* v. *Henry Prentiss*, 288 U. S. 73. "No matter though the claim for refund be specific and limited, the Commissioner is at liberty to audit the return afresh and to strike a new balance as the facts may appear. Commonly, though, it seems, not always, a general audit will be necessary or will be at least a wise precaution, whether the claim is broad or narrow, if the government is to have the benefit of any compensating adjustments. There is little doubt that this conception of duty and prudence has had recognition and emphasis in administrative practice." *U. S.* v. *Memphis Cotton Oil*, 288 U. S. 70. "A general claim for refund may be amended after the period of limitations by specifying the grounds." *U. S.* v. *Memphis Cotton Oil, supra.* "As long as the tax remains overpaid, there should be no concern as to how often the Commissioner may have to investigate or re-audit the return because of amendment to the original claim for refund since the claim is equitable in nature." (*Big Diamond Mills* v. *U. S.*, 51 F. (2d) 721) and "brings within its range whatever facts reside in the domain of equity and conscience." *U. S.* v. *Factors & Finance, supra.*

The taxing statutes provide that, in order that a suit for refund of taxes overpaid may be maintained, it must be based on a duly filed claim for refund. The Regulations, promulgated by the Commissioner, provide that the claim for refund should contain a statement of the facts upon which the claim is based. "The line of division must be kept a sharp one between the function of a statute requiring the presentation of a claim within a given period of time, and the function of a regulation making provision as to form. The function of the statute, like that of limitations generally is to give protection against stale demands. The function of the regulation is to facilitate research

The Commissioner—may disallow the claim promptly for a departure from the rule. If, however, he holds it without action until the form has been corrected, and *still more clearly if he hears it, and hears it on the merits, what is before him is not a double claim, but a claim single and indivisible, the new indissolubly welded into the structure of the old. U. S.* v. *Memphis Cotton Oil, supra.* All of the letters, briefs, and claims forms filed by the appellant subsequent to the filing of the original claims for refund were meant to satisfy the requirement of the regulations as to the form and to supply the Commissioner with more facts in support of the original claims for refund, and were in effect and in fact amendments to the original claims for refund and so considered by the Commissioner. (Pl. Ex. 6) R. 177; (Jt. Ex. H) R. 180; (Par. n-1) R. 64.

Since the maintenance of this action is dependent on the due filing of a claim for refund and the complaint may not be based on any allegation not made in the claim for refund, the claim for refund is a pre-trial proceeding which, upon institution of this action, become a part of the trial proceeding. The amendment of the claim for refund had the effect of an amendment of the complaint in this action, since the complaint could not allege anything not alleged in the claim for refund. "The general rule is said to be that an amendment of a pleading will take effect by relation and thus relieve against the bar of an intervening limitation if the identity of the cause of action is still substantially the same." *Baltimore & O. S. W. R. Co.* v. *Carroll,* 280 U. S. 491; *Seaboard A. L. R.* v. *Renn,* 241 U. S. 290. Since the appellee has had notice in the original claims for refund that appellant "is trying to enforce a claim against it because of specified conduct, the reasons for the statute of limitations do not exist, and—a liberal rule should be applied" *New York Central & H. R. R.* v. *Kinney,* 260 U. S. 340; *U. S.* v. *Memphis Cotton Oil, supra.*

Finally, as this action was brought under the provisions of section 24 (20th) of the Judicial Code, providing that

actions brought thereunder are timely if brought within six years after the cause of action arose, it appears to have been timely brought, since none of the original rejections occurred more than six years prior to the bringing of the action, and since either the original or the final rejection of the claim, for each of the years in suit, gave rise to the six separate causes of action comprising this action.

Plaintiff's claims for refund, for 1926 and prior years, were duly filed and amended. On May 26, 1928, for 1923 (R. 57), and on May 16, 1929, for the years 1924 and 1925 (R. 63), the plaintiff duly filed claims for refund, alleging in support thereof, that depreciation sustained was not allowed and that deductions taken for depreciation, donations and repairs were erroneously disallowed. On May 25, 1929, as proposed in his letter of March 13, 1929 (R. 62), the Commissioner disallowed deductions taken in the plaintiff's books and returns for depreciation, donations and repairs, for the years 1924, 1925 and 1926. On May 25, 1929, based on said disallowances, in reverse of the actions requested in the said claims, the Commissioner assessed deficiencies in taxes for those years. In a letter, dated June 7, 1929 (R. 64), the Commissioner stated that the claims for refund will be rejected "inasmuch as the information is complete." Similar claims were held to have been specific in the case of *U. S.* v. *Factors & Finance,* 288 U. S. 89. The said claims were thereafter rejected. The said rejections were erroneous and illegal and were, thereafter, set aside by the Commissioner in reconsidering the claims on their merit, as promised by him in his letter dated June 29, 1929. (R. 64.) The Commissioner had a right to waive his objection and the rejection based thereon. *Tucker* v. *Alexander,* 275 U. S. 228. On February 25, 1930, the Commissioner's office sent a letter to the taxpayer, referring to the taxpayers letter of June 22, 1929, and stated "Careful consideration has been given * * * this office finds no basis for * * * reconsideration * * * Your request is, therefore, denied." (R. 67.) This last rejection was never approved by the Commissioner on a schedule or otherwise.

Any rejection of the plaintiff's specific claims for refund is erroneous and illegal and does not start the running of the statute of limitations. *N. Y. C.* v. *Kinney*, 260 U. S. 340. It has been shown herein that the Commissioner did not compute allowances for depreciation on the basis of the fair market value, as of either March 1, 1913, or as of June 30, 1922, although such values are greatly in excess of the book record of the cost as of those dates, and that the Commissioner did not even substitute the depreciated cost for the fair market value. Under such circumstances, it has been held that the Commissioners determinations were erroneous, without rational foundation, and should be set aside. *Clinton Cotton Mills* v. *Commi*, 78 F. (2d) 292 (CCA-4); *Helvering* v. *Taylor*, 292 U. S. 507. The determinations of the Commissioner and his rejections of the plaintiff's claims for refund, based on his determinations, are illegal and, therefore, nullities. *U. S.* v. *Anderson*, 60 F. Supp. 649, and being nullities, the said rejections did not start the statute of limitations running.

The Commissioner's determinations being presumed to be correct (*Lukas* v. *Struct. Steel Co.*, 281 U. S. 264), he is presumed to know the provisions of the taxing statutes and the regulations which he promulgated. Without the filing of a claim for refund, within five years after the return was due to be filed for the year 1923, and within the period prescribed for subsequent years, the Commissioner is required to examine the return and determine the correct amount of the tax due. Sec. 250 (b), Rev. Act of 1921, provides: "As soon as practicable after the return is filed, the Commissioner shall examine it. * * * If the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252." Sec. 252, provides: "That if, upon the examination of any return * * * it appears that an amount of * * * tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes * * * the excess shall * * * be immediately refunded * * * provided, That

no such * * * refund shall be made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor * * * or unless before the expiration of two years from the time the tax was paid a claim therefor is filed by the taxpayer * * *." Similar provisions are in sections 271 and 272 of subsequent revenue acts. If the taxpayer believes the tax is overpaid, it is required to do no more than file the claim for refund, as provided in section 252, *supra.* The originally prescribed period in which the Commissioner is required to examine the return and to determine the correct tax due is merely extended by the filing of the claim for refund. "The ultimate question presented for decision upon a claim for refund, is whether the taxpayer has overpaid the tax. This involves a redetermination of the entire tax liability." *Lewis* v. *Reynolds,* 284 U. S. 281. The Commissioner cannot shift his duty to the taxpayer by having promulgated Art. 1304, Reg. 69, providing that, "All facts relied upon in support of the claim should be clearly set forth in detail under oath," since he was without authority to shift his duty. Section 1101, Rev. Act of 1926, provides that, "The Commissioner * * * shall prescribe and publish all needful rules and regulations for the enforcement of this Act." It does not provide for the avoidance by the Commissioner of the duties prescribed in that Act. A rejection of a claim based on a taxpayer's failure to do that which is not prescribed in the Act, for failure to relieve the Commissioner of his prescribed duties, is contrary to law, illegal and a nullity.

The taxing statutes do not authorize the Commissioner to reject a claim for refund, but provide that refund will not be made under certain circumstances. There is a differenec between rejecting a claim for refund and failing to make refund. To reject a claim for refund, before the taxpayer and the Commissioner together agree that the tax has either not been overpaid or that proof thereof cannot be found, is an attempt by the Commissioner to avoid his duty.

"As long as the tax remains overpaid, there should be no concern as to how often the Commissioner may have to investigate * * * because of amendment to the original claim for refund since the claim is equitable in nature (*Big Diamond Mills* v. *U. S.*, 51 F. (2d) 721), and "brings within its range whatever facts reside in the domain of equity and conscience." *U. S.* v. *Factors & Finance,* 288 U. S. 94.

Although not required to do so, the taxpayer submitted under oath certain facts in support of its claim for refund. "Where a defendant has had notice * * * that the plaintiff sets up and is trying to enforce a claim against it because of specified conduct, the reasons for the statute of limitations do not exist, and we are of the opinion that a liberal rule should be applied." *N. Y. Central & H. R. R. Co.* v. *Kinney,* 260 U. S. 340. Without contending that any of the claims for refund are barred by the statute of limitations or that they are barred because of prior rejections, on July 30, 1931, the Commissioner wrote the taxpayer (Jt. Ex. "H") (R. 59-180), reciting the facts submitted in support of the claims for refund, for the years 1923 to 1928, inclusive, stating that the claims will be rejected unless the taxpayer desires and arranges for a hearing, the proposed rejection being on the merits. The final rejection, on October 23, 1931, within two years before this suit was started, being based on the said letter of July 30, 1931, was a rejection on the merits of the plaintiff's original claims for refund as finally amended for the years in suit.

All rejections made prior to October 23, 1931, were similarly set aside by the Commissioner and he subsequently reconsidered those claims on their merit as shown by the Commissioner's letters, of June 29, 1929 (R. 64), of February 25, 1930 (R. 67), of September 6, 1930 (R. 68), of January 13, 1931 (R. 69), and of July 30, 1931. (Jt. Ex. "H".) (R. 70.)

If rejections by the Commissioner were meant to be authorized by statute, section 1113 (a), providing that suit can not be maintained if brought more than two years after

rejection of the claim, it does not appear that it was intended that the Commissioner was to be authorized to reject a claim for refund for any other reason than that the claim is barred by the statute of limitations. Where the bar of the statute of limitations is in question, the sooner such a question is settled, the better it may be for both parties, and an early rejection and a suit based thereon may work to the best advantage of both parties, and if the Commissioner is held to have erred the taxpayer will be entitled to prove his claim. Such theory, that rejections may be used only with respect to claims barred by the statute of limitations, is reasonable, more nearly preserving the taxpayer's equitable rights, and is in harmony with the holding of the courts that, where the defendant has had due notice of a claim for refund because of specified conduct, the statute of limitations do not apply (*N. Y. C. & H. R. R. Co.* v. *Kinney, supra*), since such a claim is equitable in nature (*Big Diamond Mills* v. *U. S., supra*), and "brings within its range whatever facts reside in the domain of equity and conscience" (*U. S.* v. *Factors & Finance, supra*), and "as long as the tax remains overpaid, there should be no concern how often the Commissioner may have to investigate." *Big Diamond Mills* v. *U. S., supra.*

Finally, if the Commissioner does not reject the claim for refund, but indicates that he does not intend to make further investigations or to refund the amount claimed, a right accrues to the taxpayer to petition the United States District Court for a hearing with respect to its rights under that claim. This suit, having been brought under the provisions of Par. (20) of Section 24 of the Judicial Code, within six years after the cause of action arose, was duly started, that paragraph providing: "No suit against the Government of the United States shall be allowed under this paragraph unless the same shall have been brought within six years after the right accrued for which the claim is made * * *." Under that section, since there were no rejections, legal or otherwise, prior to October 23, 1927, the suit was duly filed on October 23, 1933.

"Sec. 202(a) That the basis for ascertaining the gain derived or loss sustained from a sale *or other disposition* of property * * * acquired after March 1, 1913, *shall* be the cost * * * except that—

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property * * * acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—(1) If its fair market value as of March 1, 1913, is in excess of such basis, the gain to be included in gross income *shall* be the excess of the amount realized therefor over such fair market price or value; (2) If its fair market price or value as of March 1, 1913 is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; * * *".

The term "or other disposition of property" is meant to include the gradual sale of the property through depreciation allowances, as was held in *Ludy* v. *United States*, 274 U. S. 295. Therefore the provisions of section 202, *supra*, are related to the provisions of section 234 (a) (7), Rev. Act of 1921:

"Sec. 234. (a) That in computing net income * * * there *shall* be allowed as deductions: * * * (4) Losses sustained during the taxable year * * * (7) A reasonable allowance for the exhaustion, wear and tear of property * * * including * * * obsolescence. In the case of property acquired before March 1, 1913, this deduction *shall* be computed upon the basis of its fair market value as of March 1, 1913; * * *" (Emphasis supplied.)

The provisions of sections 202 and 234, *supra*, are also related to the provisions of sections 250 and 252, Rev. Act of 1921, as follows:

"Sec. 250 (b) As soon as practicable after the return is filed, the Commissioner *shall* examine it. If it appears that the correct tax is greater or less than that shown in the return, the installment shall be recomputed. If the amount already paid exceeds that which should have been paid * * * the excess *shall* be cred-

ited or refunded to the taxpayer in accordance with the provisions of section 252. If the amount already paid is less than that which should have been paid, the difference * * * (hereinafter called "deficiency") * * * *shall* be paid upon notice and demand by the collector. * * * (d) The amount of * * * taxes due under any return made under this Act * * * *shall* be determined and assessed by the Commissioner within four years after the return was filed * * *".

"Sec. 252 (Amended March 4, 1923) (a) That if, upon examination of any return of income made pursuant to this Act * * * it appears that an amount of * * * tax has been paid in excess of that properly due, then * * * such excess *shall* be immediately refunded to the taxpayer * * *" (Emphasis supplied).

The emphasized word "*shall*" as used in sections 202, 234, 250 and 252, *supra,* has an imperative meaning, the same as if the word "must" was substituted therefor, and relates specifically and only to the duties of the Commissioner therein prescribed. As soon as practicable after the return is filed, the Commissioner, pursuant to the provisions of section 250 (b) *must* determine the tax properly due (which he cannot do without he first determines the correct net income which he *must* do, in accordance with the provisions of Section 234, and allow depreciation computed on the basis of the fair market value as of March 1, 1913, of property acquired before that date), and, if the tax reported due on the return and paid exceeds that properly due he *must* refund the amount overpaid in accordance with the provisions of Section 252, or if so reported due and underpaid he *must* assess the deficiency.

Until the Commissioner has determined the correct net income and the tax properly due as required of him by sections 234 and 250, respectively, and has refunded any overpayment of the tax as required of him by sections 250 and payer is without any authority to compel him to comply. Whether he complies depends upon his conscience. The taxpayer is without any authority to compel him to comply.

Having been under compulsion of sections 202, 234, and 250, to determine the taxpayer's net income and the tax properly due, and, in accordance with section 252, to refund any tax that has been overpaid, for each of the years in suit, the Commissioner was not relieved of such compulsion upon the filing of claims for refund for those years. By process of law, the compulsion on the Commissioner was continued indefinitely because of the fact that the duly filed claims for refund waived the statute of limitations indefinitely and permit the Commissioner to refund the overpaid tax at any time he determines the amount of such overpayments. Section 252, *supra,* provides a bar only with respect to claims for refund that are filed after the time therein prescribed for the due filing has expired. Having admitted that the taxpayer's claims for refund were duly filed, the Commissioner did not reject them on the ground of being barred by the statute of limitations. Being under compulsion to determine the correct net income and the tax properly due and to refund any tax overpaid, which he had not yet done, for each of the years in suit, and having no authority to reject a claim for refund on the merits, the Commissioner's rejections of the taxpayer's claims for refund, are contrary to law and do not legally exist. Knowing that fact, the Commissioner nullified his earlier rejections of the claims, in each instance, by promising to reconsider them, P. T. F. (R. 60-72), thus waiving any irregularity that the Commissioner had in mind as a basis for his prior rejection. The Commissioner had such right. *Tucker* v. *Alexander,* 275 U. S. 228. A bankrupt, freed of his debts by the bankruptcy court, revives any of such debts if subsequently he promises to pay them, thus setting aside the order of that court in that regard. Knowing that he had no right to reject the claims on their merit, and that his earlier rejections had no basis, since he had refused to comply with the law and to determine the correct net income, tax properly due, and the amount of tax overpaid, the Commissioner had a right either to nullify or to correct his

earlier erroneous rejection, which he did on October 23, 1931, as shown in the pretrial findings of fact, adopted by the trial court. (Par. (n), R. 60.)

The trial court erroneously held in effect that the rejection on October 23, 1931, within two years prior to the beginning of this action, related only to amendments of the claims made since their earlier rejection. There is nothing in the record, in the Schedule of rejections, dated October 23, 1931, or in the Commissioner's letter of the same date, referring to that schedule, to indicate that the Commissioner's final rejection, of all the claims in suit, was not intended by him to take the place of any earlier rejections. Par. (y), pre-trial findings states, "On October 23, 1931, the Commissioner rejected all claims of plaintiff then pending * * *" (R. 60). Par. (x) P. T. F., (R. 70), shows that the Commissioner considered that the original claims were pending and not finally rejected; In his letter of July 30, 1931, (Jt. Ex. H), the Commissioner wrote the plaintiff that, for the reasons therein stated its claims for refund for the years 1923 to 1928, inclusive, "have been considered and will be rejected", (Par. (x), R. 70), that letter further stating, "The claims are based on the statement that inadequate deductions for depreciation were allowed you in each year; * * *"

The P. T. F. (R. 53-75) also show, as a result of the taxpayer's continued objections to the prior rejections of its claims for refund, that thereafter the Commissioner agreed to reconsider his prior rejections and he partially allowed claims, previously rejected, for the years 1924, 1925 and 1926, as follows; On June 29, 1929, the Commissioner wrote the taxpayer, stating that careful consideration will be given to the additional information received with respect to the claims for the years 1924 and 1925, which had been rejected in their entirety, on June 28, 1929, (Pars. (n) and (n-1), R. 64, 65); On February 25, 1930, the Commissioner wrote the plaintiff, stating that consideration was given to the additional information received, (Par. (r), R. 67); On

Sept. 20, 1930, the taxpayer again wrote the Commissioner requesting his further reconsideration of his rejection of the claims for the years 1924, 1925 and 1926, (Par. (s-1), R. 68); On January 13, 1931, the Commissioner nullified his prior rejections for those years and partially allowed the taxpayer's claims for the years 1924, 1925 and 1926 (Par. (t), R. 69); On April 25, 1931, plaintiff submitted additional information and requested further reconsideration (Par. (v), R. 69); On July 30, 1931, the Commissioner wrote the plaintiff (Jt. Ex. H), clearly indicating that he had reconsidered on their merit all the claims for refund in both their original and amended form, for the years in this suit, and that he had finally determined, unless the taxpayer informed him, within thirty days, of its desire to have a conference on the matter at Washington, he would reject all claims in their original form and as amended to date, having been amended by the taxpayer, having also been amended by the Commissioner through partial allowance of the claims for the years 1924, 1925 and 1926, that letter reading as follows; * * * "Your claims for refund * * * for the calendar years 1923, 1924, 1925, 1926, 1927 and 1928, * * * have been examined and will be rejected for the following reasons: The claims are based on the statement that inadequate deductions for depreciation were allowed you in each year; that for the years 1924 to 1926, inclusive, amounts expended for renewals and replacements were charged against the depreciation reserve, which amounts should have been allowed as repairs * * * contributions * * * were disallowed as donations * * *. Under date of June 26, 1931, an affidavit was filed making claim for additional refunds * * * on the ground that your accounts receivable are inventory and should have been included on the balance sheets at cost or market whichever is lower. * * * If you do not acquiesce in the proposed action relative to your claims and desire a hearing * * * at Washington, such hearing will be granted if written request is made therefor within thirty days from the date of this

letter. If a hearing is not requested, the rejection of these claims will be officially scheduled at the expiration of the period indicated."

The record facts clearly show; that the Commissioner determined to and did set aside or nullify his earlier rejections of the claims for refund; that he reconsidered the claims thereafter from time to time; that, on October 23, 1931, he finally rejected the claims in both their original and amended form. As the Commissioner's determinations are presumed to be correct, it must be presumed that he knew what he was doing and why he did it. He certainly knew that his earlier rejections were contrary to law, therefore, illegal, and that he had a right to set them aside in order to give further consideration of the claims.

The defendant-appellee did not allege in its answer or in the proceedings that the Commissioner erred in setting aside its earlier rejections and in reconsidering the taxpayer's claims thereafter, and if it now claims such error it has not met the burden resting upon it to show that the Commissioner erred in so doing. As the Commissioner's determinations are presumed to be correct, the burden of proof rests on him who contends that he erred. *Lucas* v. *Structr. Steel,* 281 U. S. 264; *Welch* v. *Helvering,* 290 U. S. 111. The Commissioner's decision in favor of a taxpayer, in the absence of fraud or mistake, is an award all sufficient for the foundation of a judgment. *Woolner* v. *U. S.,* 13 Ct. Cls. 355; *Sybrant* v. *U. S.,* 19 Ct. Cls. 461. In the case of *U. S.* v. *Factors & Finance Co.,* 288 U. S. 89, 96, the Supreme Court held, "It is a question that in last analysis is addressed to his own conscience, and in the absence of any evidence impeaching his conclusion his certificate of satisfaction or the contrary is binding on the courts." As there is no provision in the revenue acts permitting the Commissioner to reject a claim for refund on its merit, or to prevent the Commissioner from setting aside a rejection of such a claim that was erroneously or illegally made, the Commissioner properly set aside his prior rejections of

the taxpayer's claim for refund in order to permit further consideration thereof.

The trial court erred in holding that the taxpayer did not meet the burden resting upon it to support its claims for refund. The Commissioner is without legal authority in his effort to shift his responsibility to the taxpayer by the promulgation of articles 165 and 1036, Reg. 62, providing; "Art. 165, * * * In the absence of proof to the contrary, it will be assumed that such value as of March 1, 1913, is the cost of the property less depreciation up to that date * * *" and, Art. 1036, * * * "Claims for the refunding of taxes * * * erroneously or illegally collected shall be made on Form 843. In this case the burden of proof rests upon the claimant. All the facts relied upon in support of the claim *should* be clearly set forth under oath. * * *" (Emphasis supplied.)

Since the Commissioner did not determine the book record cost less depreciation as of March 1, 1913 and use such value as a basis for computing depreciation allowances for such property, as is clearly shown by the computations in Schedule 4, *supra*, it does not appear that the Commissioner believed in the validity of his own regulation, since the article consists of an attempted amendment of the provisions of section 234 (a) (7) of the Rev. Act of 1921 which he had no legislative power to make. Obviously, that portion of Art. 165, as quoted, is invalid and without any effect.

The record shows that the rejection of the taxpayer's claims was not because of its failure to support them, but because the Commissioner stubbornly resisted both the claims and the law.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

> 16. In failing to decide that the Commissioner's determinations to reject the petitioner's claims for refund are excessive, arbitrary, contrary to the provisions of law, and without rational foundation, that any presumption of correctness of his determinations that may

have originally attached thereto were destroyed, that the burden of proof has shifted from the petitioner to the Commissioner and the respondent, and that the Commissioner's determinations should be set aside and considered to be nullities.

Notwithstanding that the Commissioner is presumed to be fully cognizant of all provisions of the revenue acts, particularly of the provisions of the regulations promulgated by him, and of his duty, therein prescribed, to correctly determine the taxpayer's net income and taxes due pursuant to the provisions thereof and notwithstanding that the taxpayers filed claims for refund, for 1928 and all prior taxable years, calling his attention to the fact that he was continuously determining the taxpayer's net income and taxes due in amounts greatly in excess of the correct amounts therefor, it was shown, under specified errors number 5, 14 and 15, supra, that the Commissioner, in violation of the applicable law and regulations, continuously, therefore willfully, determined the petitioner's net income and taxes due in amounts greatly in excess of the amounts required by law; that he refused to permit an adjustment of the predecessor's books of account, for 1928 and prior years, pursuant to the provisions of articles 831 to 844, inclusive Reg. 62, supra; and that he refused to allow deductions for depreciation, for 1922 and prior years, computed on the basis of the fair market value as of March 1, 1913 of property acquired before that date; that he refused to allow deductions for depreciation, for the years 1923 to 1928, inclusive, computed on the basis of the fair market value as of either June 30, 1922 or March 1, 1913 of property acquired before those dates.

Notwithstanding that he disallowed most of the predecessor's claim for refund, for the year 1918, on the basis of his determination that, on June 30, 1922, the predecessor sold its property to this petitioner in exchange for the petitioner's capital stock, the Commissioner disallowed the petitioner's claim for refund, for the years in this action, on his

subsequent determination that, on June 30, 1922, the property was not sold, and, instead, it was exchanged pursuant to a plan of reorganization, a definite reversal of his earlier determination with respect to the same transaction in defeat of the petitioner's claims in each determination.

As the Commissioner's determinations in this and the former action are clearly arbitrary, are in violation of the provisions of both law and regulations, and are without rational foundation, any presumption of correctness that would have otherwise have attached thereto has been dispelled and no longer exists (*Russell* v. *Comm.*, 45 F.(2d) 100, 103) and his determinations should be set aside (*Helvering* v. *Taylor*, 292 U. S. 507) and the court was charged with the duty of doing that which the Commissioner failed of his duty to do. *B. F. Sturtevant* v. *Comm.*, 75 F.(2d) 316.

The Commissioner's determination that for the purposes of this action the transaction as of June 30, 1922, whereby the petitioner acquired the property of the predecessor, should be construed pursuant to the provision of sections 203 and 204 of the Revenue Act of 1924 rather than under the provisions of section 202 of the Revenue Act of 1921, which is in conflict, both in result and theory, with the decision of this Court in the case of *Reo Motors Inc.* v. *Comm.*, 338 U. S. 442.

The decision of the court that the Commissioner's determinations are correct is reversible error. *Helvering* v. *Taylor, supra; B. F. Sturtevant Co.*, v. *Comm., supra.*

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

17. In failing to grant judgment for the petitioner in the full amount prayed for in the complaint.

The United States Court of Appeals for the Fourth Circuit, in this action, erred:

18. In failing to take judicial cognizance of the facts and taxable history of the petitioner and its predecessor, held by it to be the same taxpayer, and to decide

that, notwithstanding the petitioner's repeated efforts to obtain refund and other relief through the remedies provided at law, the Commissioner, under guise of his authority, has continuously exacted excessive taxes from the petitioner and has illegally held the property of the taxpayer for the benefit of the respondent in violation of the Fifth and Fourteenth Amendments to the Constitution of The United States.

The printed record on appeal in this and the former actions, and Defendant's Exhibits E and H, shows; that, for 1913 and all subsequent years, in deliberate disobedience of law and the regulations he promulgated, the Commissioner erroneously and illegally disallowed deductions, determined net income and taxes due in excessive amounts and caused the same to be demanded of and paid by the taxpayer; that, although the taxpayer duly filed claims for refund, setting forth the facts resulting in such overpayments of the tax, for each of the years, the Commissioner refused to refund such overpayments; that, since the taxpayer's claims for refund had been erroneously and illegally rejected and refund had not been and would not be obtained, the taxpayer started, successively, three different actions, two of which were for refund, and of which, one was for a redetermination by the Board of Tax Appeals; that, on the basis of technicalities, the trial courts refused to order refunds of the overpayments of the tax, and the Board refused to make a redetermination of no deficiency in payment of the tax; that, being without legal authority, the courts did not order the Commissioner to discontinue, for subsequent years, his erroneous and illegal determinations and procedures of the past.

Having received no orders to desist, the Commissioner has continued to determine the taxpayer's tax liabilities, for subsequent years, on the same erroneous basis as of the past. It is sufficient to say that the Commissioner has continued his erroneous and illegal practice of the past in his determination of the taxpayer's tax liabilities for subsequent years.

If the decisions and interpretation of the provisions of sections 202, 234, 250 and 252, of the Revenue Act of 1921, and similar provisions of the subsequent revenue acts involved, as applied to the facts, in this and the two former actions, were properly made by the courts, it appears that the Commissioner has taken and continues without due process of law to take property from and belonging to the taxpayer, in violation of the Fifth and Fourteenth amendments to the Constitution, and that there is no plain, adequate and complete remedy at law for the taxpayer's recovery of property so taken in the past and to prevent continuance of such taking of its property in the future.

It has been held that, where otherwise there was a plain, adequate and complete remedy at law, but that the basis of the action for recovery was of a continuing nature and a rescission of a fraudulent contract or a restraining order was necessary for complete relief, in addition to the damages sought, then the judgment at law is not adopted to the end in view, and equity will take jurisdiction. *Thompson* v. *Allen,* 115 U. S. 554; *Buzard* v. *Houston,* 119 U. S. 352. A remedy at law is not adequate, and not as prompt and efficient as in equity, where it depends on the will of the opposing party, as in this case depending on the will of the Commissioner, whose determinations are presumed to be correct although shown to be clearly contrary to the provisions of law. *Brown* v. *Pac. Mut. Life Ins. Co.* (C. C. A. 4th) 62 F. (2d) 711; *N. W. Mut. Life Ins. Co.* v. *Wiggins,* 15 F. (2d) 646, Cert. Dnd. 273 U. S. 746; *Schwartz* v. *Northern L. Ins. Co.,* 25 F. (2d) 555, Cert. dnd, 278 U. S. 628. A remedy at law does not exist where a multiplicity of actions are required to obtain adequate relief. *Oelrichs* v. *Spain,* 15 Wall. 227; *Mut. L. Ins.* v. *Blair,* 130 Fed. 971; *Mills* v. *Chicago,* 127 Fed. 735, and innumerable others.

The Fourteenth Amendment applies to every person who is a repository of authority of his acts done under guise of such authority, but in excess thereof. *Home Tel. & Tel. Co.* v. *Los Angeles,* 227 U. S. 278; *Fidelity & D. Co.* v. *Tafoya,*

270 U. S. 426. Unconstitutionality may be shown by things judicially noticed or by facts established by evidence. *Weaver* v. *Palmer Bros. Co.*, 270 U. S. 402.

The amount of tax overpaid to and held by the respondent in excess of the tax properly due under the applicable revenue act, for each of the years in this action, is money or property belonging to the petitioner, the exaction, collection and holding of which is in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States. The Fifth Amendment provides that;

> "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, * * * nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

The taxes levied by the revenue acts are moneys to be obtained for the use of the respondent, therefore, if a tax is excessively exacted, collected and retained it consists of property taken from the taxpayer for public use. Herein it was shown that the Commissioner exacted and there was collected taxes from the petitioner, for the years in this action, in excess of the taxes due under the applicable revenue acts; that he refused to refund the overpaid taxes; and that the respondent continues to hold the money overpaid as taxes, consisting of property belonging to the petitioner. The respondent has not compensated the petitioner for its property thus taken wrongfully for public use, nor could it justly compensate the petitioner therefor without refunding the overpayment with interest, as prayed for in the complaint. The taking of the money as an overpayment of the taxes for public use, and the refusal to refund it with interest constitutes a violation of the Fifth Amendment, supra, which provides for the equal protection of the laws

and operates directly in limitation and restraint of powers conferred by the Constitution (*Hepburn* v. *Griswold,* 75 U.S. 603; *Broderick's Ex'r* v. *Magraw,* 75 U.S. 639) and limits the power of the government in its dealings with the citizen, and relates to that class of rights whose protection is peculiarly with the province of the judicial branch of the government. *U.S.* v. *Lee,* 106 U.S. 196.

The Constitution of the United States and the amendments thereto are designed to conform and harmonize with the laws of the States and to provide for the carrying out of those laws as between the States, to do that which the State could not do, and to protect the citizen where the State has failed to do. Section 1 of the Fourteenth Amendment to the Constitution, provides;

> "All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

A corporation is a person within the meaning of the provisions of the Fifth and Fourteenth Amendments forbidding the deprivation of property without due process of law. *Grosjean* v. *American Press Co.,* 297 U.S. 233, 244; *Liggett Co.* v. *Baldridge,* 278 U.S. 105. The Fourteenth Amendment sought an equality of treatment of all persons, even though all enjoyed the protection of due process. *Stewart* v. *Kansas City,* 239 U.S. 14; *Newark* v. *New Jersey,* 262 U.S. 192; *Joselyn Mfg. Co.* v. *Providence,* 262 U.S. 668.

Notwithstanding the provisions of the Fifth and Fourteenth Amendments, *supra,* the provisions of sections 234 (a) (7) 250, and 252 of the Revenue Act of 1921 and similar provisions of the subsequent revenue acts, and the further fact that; (a) the Commissioner was well aware of the

aforesaid provisions and his duty pursuant thereto; (b) his attention was repeatedly called, through claims for refund for 1916 and each of the subsequent years, of the inadequacy of his allowances for deductions for repairs and depreciation; (c) and, his attention was additionally called as to his failure of duty and violations of law in three different actions in court, he wilfully and continuously violated the law and failed to allow deductions of all of the costs of repairs and of depreciation computed on the basis of the fair market value as of the basic date of property acquired before that date. There was no provision of law providing for the punishment of the Commissioner for his violations or to prevent his wilfull continuance thereof in subsequent years. The fact that the court, in the former action, held that the claims for refund for 1919 and prior years did not comply with the provisions of the regulations was no excuse for the Commissioner's failure to do his duty in the first place or to continue thereafter in such failure, since, being presumed to be an expert in the administration of the tax laws, he is presumed to have known of his violations of the provisions thereof. Therefore, it appears that the remedy at law was not adequate to effect the refund of the overpaid taxes or to prevent the continued taking of the taxpayer's property without just compensation or without the intention of any compensation therefor.

The court erred in deciding that the Commissioner correctly determined the petitioner's net income and the taxes due, for the years herein, otherwise, it must be concluded that the provisions of the revenue acts permitting the Commissioner to do as he did are in violation of the provisions of the Fifth and Fourteenth Amendments of the Constitution of the United States.

CONCLUSION.

Whether or not the decision, in that former action, was on the merits with respect to the claims for refund on account of depreciation, and whether or not that decision is res judicata in this action, the result is the same. The property having been purchased by the petitioner since March 1, 1913, the deductions and allowances for depreciation thereof must be based on the cost or purchase price, as provided in section 234 (a) (7) of the Revenue Act of 1921, *supra*. But as the court found that, on June 30, 1922, the predecessor sold all of its property to the petitioner and the petitioner paid therefor its capital stock, the purchase price or cost to the petitioner was its capital stock paid for the property. The seller and the purchaser having agreed that the petitioner's capital stock and the predecessors property were of the same value, the money value of the capital stock was equal to the fair market value of the property purchased by the petitioner on June 30, 1922. *Hazeltine Corp.* v. *Comm., supra.* As the Commissioner refused to allow depreciation on the cost, in this case the fair market value as of June 30, 1922, he exacted taxes in excess of the taxes due under the law, thereby taking the petitioner's money or property for the public use, and in refusing to refund the overpaid taxes, he refused just compensation for the property so taken, all in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States.

It is, therefore, respectfully submitted that the Petition for Writ of Certiorari should be granted as prayed for.

Respectfully submitted,

LEONARD MARSHALL
Attorney for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1949.

No. 728.

UNION BLEACHERY, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent.*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

PETITIONERS' REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION.

In the preparation of its petition for a writ of certiorari and the supporting brief, the petitioner followed the form of certain petitions that have been filed by others, and earnestly attempted to comply with the Rules of this Honorable Court. Therefore, this petitioner fails to understand in what respect its petition and brief in support thereof is in substantial disregard of Rule 38, paragraph 2,

as alleged by the respondent. Therefore, the petitioner prays that this Honorable Court will consider good intentions rather than results, substance rather than form, and that it will overlook such errors if any there be as alleged.

Although the petitioner urged in all proceedings and in this petition for writ of certiorari, with respect to property acquired before the basic date, that, for each of the years 1923 to 1928, inclusive, it is entitled to allowances for deductions of depreciation computed on the basis of the fair market value as of the basic date, which is either July 1, 1922 or March 1, 1913, whichever is determined by the Court, (Cf. Pet. Bf. 28-54) the respondent attempts to make it appear that the petitioner urges use of the fair market value as of July 1, 1922 only, as being the basic date. (Respondent's Bf., 2)

Although admitting that the Commissioner computed the allowances for depreciation on the book record of cost (beginning in 1904), and on the book record of cost of additions, and that, for the year 1923, the proper basis on which the petitioner is entitled to have its allowances for depreciation computed is the fair market value as of March 1, 1913, the respondent urges that "the Commissioner allowed reasonable depreciation deductions," that the petitioner "did not carry its burden of showing that the fair market value of the property owned on March 1, 1913 was in excess of the cost or book values," and that "both lower courts properly approved these allowances in the absence of proof establishing that the depreciation basis was too low." (Respondent's Bf. 2, 3) No such burden rested on the taxpayer. (Pet. Bf. 28-55)

Section 234 (R. 5-8) clearly provides without any exception, hindrance or aid of the taxpayer, that "(a) * * * there shall be allowed as deductions: * * * (7) A reasonable allowance for the exhaustion, wear and tear of property * * * In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market value as of March 1, 1913." As the Com-

missioner is charged with the administration of the tax laws, the directive contained in section 234 is aimed at the Commissioner, and the use of the word "shall" precludes entertainment of the respondent's theory that the Commissioner might escape his duty unless the taxpayer is able to force him. (Pet. Bf. 28-55)

Pursuant to the provisions of section 250 of the appropriate revenue act, the Commissioner "shall" examine the return "as soon as practicable" after it is filed. "If the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. * * * If the amount already paid is less than that which should have been paid, the difference, * * * shall be paid upon notice and demand by the collector." (Pet. Bf. 81) Obviously, the correct net income and tax due can only be determined if the Commissioner determines allowances for depreciation in accordance with the provisions of section 234(a)(7). (Pet. Bf. 28-54)

Without regard as to whether the taxpayer aids or hinders, the Commissioner is under compulsion to determine the correct net income and tax due, at all times, within the prescribed period after the return was due to be filed, of five, four, three and two years, pursuant to the provisions of the Revenue Acts of 1921, 1924, 1926 and 1928, respectively, and continuously after the expiration thereof if, within such periods, the taxpayer has filed a claim for refund. (Pet. Bf. 85-91) Sections 234 (a)(7), 250 (b), and 252, Rev. Act of 1921; Sections 234 (a)(7), 274(a), and 281, Rev. Act of 1924; Sections 234 (a)(7), 274 (a), and 284, Rev. Act of 1926; and Sections 23(k), 57 and 322, Rev. Act of 1928. (R. 7-14) The statutory provision for the due filing of a claim for refund was for the purpose of putting the Commissioner on notice that he had not yet performed his duty and to extend indefinitely the period during which he is compelled to determine the correct net income and tax due. (Pet. Bf. 82) All grounds upon which the petitioner's suit was based were set forth in claims for refund as originally filed or as amended.

Although the Commissioner was under compulsion to determine a fair market value as of the basic date, and had available to him all books and records of the petitioner's business together with the evidence that was submitted at the trial, he did not make such determination. Such failure has destroyed any presumption of correctness that might otherwise have attached to the Commissioners determination, since his failure was deliberate, arbitrary and without rational foundation (*Russell* v. *Commissioner,* 45 F. (2d) 100, 103) and his determination and the decision of the lower courts sustaining it should be set aside. *Helvering* v. *Taylor,* 292 U. S. 507.

Upon consideration of the entire record and of the facts available it appears that the Commissioner was strongly opposed to the making of a determination of the fair market value as of the basic date. Notwithstanding that as of March 1, 1913, it was clearly apparent that there was much more property on hand than was reflected by the book record cost as of that date, the Commissioner's agents, Epps and Friend, testified, in effect, that they accepted without question the book record costs of plant and additions acquired in 1904 and subsequent years. Testimony of Epps: "I also made an examination of the books of account of these companies to ascertain the plant account as carried upon the books over the period 1904 through 1926." He also stated for computing depreciation, "The base is cost," meaning book record cost. (Def. Ex. E, pp. 82, 83) Testimony of Friend: "In computing depreciation allowed, I based the depreciation on the capital asset account as reflected by the books, that is, the gross asset account unreduced by the reserve for depreciation." The Commissioner and his agents would not have hesitated to make a determination of the actual costs had they thought that the book record costs were in excess thereof. Their failure to determine the actual costs cannot be said to result from failure of the taxpayer, who, prior to 1914, pursuant to a conservative policy generally followed by

industry before taxation became an important factor, did not enter in its property account all of the costs of capital items that were acquired. (Pet. Bf. 28-54)

In addition to its books and records, there was submitted in evidence the testimony of the plaintiff's witnesses, Jno. W. Arrington and John A. McPherson, both having the quality of experts with respect to that of which they testified, both testifying that the actual cost and the fair market value of the property acquired before March 1, 1913 is greatly in excess of the book record of cost as of that date. Although the book record cost of the property, less land, as of March 1, 1913 and as of July 1, 1922 is $428,895.48 and $1,374,860.99, respectively, calculations based on the testimony of the witnesses Arrington and McPherson and other facts establishes that the actual cost of such property on those dates is $1,172,658.25 and $2,118,623.76, respectively, and that the fair market value is $2,233,158.61 and $3,179,124.12, respectively. (Pet. Bf. 28-54) Therefore, if any burden rested on the petitioner to support its claims for refund, it appears that it fully met such burden. The petitioner could not force the Commissioner to consider such facts.

Mr. John T. Keenan, a witness for the United States, in a former action, *Union Bleachery* v. *United States*, # 3688, 75 F. (2d) 549, urged by respondent and held by the lower courts to be res judicata, of which the record was submitted in evidence by the United States as Defendant's Exhibit E, testified; "I am a valuation engineer, and have been employed by the Bureau of Internal Revenue for nine years. I knew the type of machinery employed by the Union Bleaching & Finishing Company in 1911. * * * I am familiar with the process employed * * * I was engaged in this business during the years 1917, 1918 and 1919. I was not at this plant * * * I called there occasionally * * * I could not give you an estimate of a fair market value of the Union Bleachery property on March 1, 1913. I know about the time when it was purchased. I would say it was very much

more valuable then in 1913, because they had done good work and had established a good reputation and were able to get business that would make good money. That would be my idea of the principal reason. The fact it was a going concern, all in one piece, and well laid out had something to do with it. * * * I am not in position to say how much more by percentages or otherwise it was worth in 1913." (Def. Ex. E, pp. 86-89) According to the respondent's own witness, the fair market value as of March 1, 1913 exceeded the actual cost. With the exception of having granted a small judgment, for the year 1918, based on amortization and not involving a fair market value as of March 1, 1913, that case was dismissed for want of jurisdiction, otherwise, the fair market value as of March 1, 1913 might have been then established.

The fact, appearing in the tax returns, in the revenue agents reports and other records, that the petitioner and its predecessor earned considerable net income and paid substantial amounts of income tax, each year, is in itself proof of a going concern value that attaches to and increases the value of the property. Considering that fact and the testimony of the expert witnesses, there is ample and substantial evidence of a fair market value considerably in excess of the book record costs as of the basic date. Such facts were alleged in claims for refund filed for each of the years, and the taxpayer met any burden resting upon it to prove those claims with respect to depreciation allowances being inadequate.

Although the provisions of section 204, of each of the Revenue Acts of 1924 and 1926, are independent of and bear no relation to the provisions of section 234 (a) (7) of each of those acts, the respondent erroneously urges that pursuant thereto the bases for depreciation as provided in section 204 are the same as the bases provided for in section 234 (a) (7) (Respondent's Bf. 4). There are no grounds for the respondent's contention. The subject matter of the said sections 204 are, as stated therein, "The

basis for determining the gain or loss from the sale or other disposition of property," such basis therein being provided for use in the "Determination of amount of gain or loss" as provided for in section 202 of the said Acts. In other words, section 204 provides the basis upon which depreciation will be based in determining the depreciated value of property as a part of the process in computing the gain or loss provided for in section 202. Whereas, the subject matter of section 234 (a) (7) provided the basis for computing depreciation deductions from income for the purpose of computing net taxable income. The determination of depreciation as provided for in the said sections are for different purposes of unrelated provisions of the 1926 and prior Revenue Acts.

It is reasonable to conclude that, if the Congress had intended to that the same basis should be used in computing depreciation as a deduction from income as the amount of depreciation to be considered in computing gain or loss from sales, that such provision would have been clearly made. However, in sections 23 (m) and 114, Revenue Act of 1928, for the first time in the legislative history of the revenue acts, the Congress clearly provided that the same basis should be used in computing depreciation as a deduction from income as when computing the depreciated cost when determining gain or loss resulting from the sale of property.

Upon erroneously assuming that allowances for deductions of depreciation from income should be computed upon the basis provided for in sections 203 and 204 of the Revenue Act of 1924 rather than as provided in section 234 (a) (7) of the Revenue Act of 1921, the respondent argues inversely that the said sections 203 and 204 "do not provide that the basis for depreciation in 1924-1928 is to be determined by reference to the law applicable for the year (1922) in which the reorganization took place," and, therefore, the court below did not bring itself into conflict with this Court's decision in *Reo Motors* v. *Comm.*, 338 U. S. 442.

The petitioner reiterates all it has set forth in its petition, and, with the exception of admissions favorable to the petition, denies all allegations, statements, theories and validity of argument presented by the respondent in its brief in opposition to this petition for a writ of certiorari.

The petition for a writ of certiorari should be allowed.

Respectfully submitted,

LEONARD MARSHALL
Attorney for the Petitioner.

May 25, 1950.

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 728

UNION BLEACHERY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The petition for a writ of certiorari and the supporting brief are in substantial disregard of the requirements of Rule 38, paragraph 2, of the Rules of this Court. Although the headings in the petition itself suggest an attempt formally to comply with the Rules, and there are submitted lengthy specifications of error, the reader, even after careful study, is left uninformed as to the precise matters tendered to this Court for decision on this record. This fault might have been remedied

(though not strictly in compliance with the Rule) by a supporting explanatory brief. But the supporting brief that is submitted is neither "direct" nor "concise" as it is required by the Rule to be; its prolixity stands in the way of its use as a means of enlightenment.

Rule 38 (2) states that a "failure to comply with [its] requirements will be a sufficient reason for denying the petition." It is submitted that the petition in this case should be denied for failure to comply with Rule 38 (2).

In any event, no reason warranting the issuance of a writ of certiorari can be discerned. We need address ourselves only to a few of petitioner's many complaints, the others being, on their face and so far as comprehensible, insufficient bases for certiorari:

1. Petitioner seeks increased depreciation allowances for the years 1923-1928. Under the appropriate statutes, the taxpayer's proper basis for computing depreciation on its depreciable plant properties for 1924-1928, inclusive, was the cost or March 1, 1913, value of the properties owned on that date, whichever is greater, and the cost of properties or additions acquired thereafter. Section 204 (a), (b) and (c), Revenue Acts of 1924 and 1926; Sections 113 (a) and (b) and 114 (a), Revenue Act of 1928 (all Appendix, *infra*, pp. 10-11, 13, 14-15). The proper basis for depreciation for 1923 as to properties owned on March 1, 1913, was

their value on that date, and as to properties acquired thereafter their cost. Sections 202(a) and 234 (a) (7), Revenue Act of 1921 (Appendix, *infra*, p. 9). Taxpayer's effort to prove the March 1, 1913, value of its properties by opinion testimony failed (R. 134-135). It thus did not carry its burden of showing that the fair market value of the property owned on March 1, 1913, was in excess of the cost or book values. Since the Commissioner allowed reasonable depreciation deductions in the taxable years computed on the cost or book values of all the property, both lower courts properly approved these allowances in the absence of proof establishing that the depreciation basis used was too low.

As both lower courts correctly held (R. 292-293, 132-133), taxpayer is not entitled to use as basis the fair market values for all of the properties as of June 30, 1922, or December 31, 1922, since the reorganization in 1922 was simply a change of name and state of incorporation and not a sale of the properties by the predecessor to the taxpayer. The taxpayer, having acquired the assets through a reorganization of the type here involved, is required to use the predecessor's basis for the assets, rather than the fair market value on the date of acquisition as taxpayer argues (Br. 26-28). See Sections 203 (h) (1) (D) and 204 (a) (7), Revenue Acts of 1924 and 1926 (*infra*, pp. 10-11, 13); Sections 112 (i) (1) and 113 (a) (7), Revenue

Act of 1928 (Appendix, *infra*, pp. 13-14). Sections 204 of the 1924 and 1926 Acts and Sections 23 (m) (Appendix, *infra*, pp. 10-11, 13-14), 113 and 114 of the 1928 Act specifically prescribed the basis on which depreciation deductions for the years to which those acts apply are to be computed. They do not provide that the basis for depreciation in 1924-1928 is to be determined by reference to the law applicable to the year (1922) in which the reorganization took place.[1] Hence, in applying the Revenue Acts of 1924, 1926 and 1928, as prescribing the correct basis for computing depreciation in 1924-1928, inclusive, the court below did not bring itself into conflict with this Court's decision in *Reo Motors* v. *Commissioner*, 338 U. S. 442 (cf. Pet. 8, 28), which turned upon highly complex statutory provisions dealing with carry-overs. Furthermore, taxpayer's unsatisfactory opinion evidence failed to establish the fair market values of the assets in 1922 (R. 134-135), even assuming *arguendo*, contrary to the statutory provisions, that the 1922 fair market values represented taxpayer's correct basis.

Since the decision on the merits is correct, it is unnecessary to discuss taxpayer's contention (Br. 12-23) that the two prior decisions determining the

[1] Although the Revenue Act of 1921, which governs the taxable year 1923 only (see *supra*, pp. 2-3), did not contain the specific provision to this effect contained in all the later Acts and the Internal Revenue Code, the same result is required, since the transaction, although called a reorganization, was actually only a change of name and place of incorporation. As will shortly be noted, moreover, the claim with respect to 1923 is, in any event, barred by the statute of limitations.

taxpayer's allowable depreciation for 1916-1922, inclusive, are not *res judicata* for the taxable years.

Finally, as the Court of Appeals held (R. 293), the District Court had no jurisdiction over the suit in so far as it claimed additional depreciation deductions for 1923, 1924 and 1925, under Section 3226 of the Revised Statutes as reenacted by Section 1113 (a), Revenue Act of 1926 (Appendix, *infra*, pp. 12-13), since the suit was not filed within two years after the taxpayer's claims for refund for these years based on the ground of inadequate depreciation allowances were rejected (R. 146-148, 279). Cf. *United States* v. *Michel*, 282 U. S. 656, 659. The second refund claim for 1923 and the third refund claims for 1924 and 1925 merely reiterated the demand for additional depreciation made in the original claims which had already been rejected (R. 146-148) and the taxpayer could not extend the period for filing suit prescribed by Section 3226 by filing other claims based on the same ground after the original claims had been disallowed. *Einson-Freeman Co.* v. *Corwin*, 112 F. 2d 683, 684 (C. A. 2d), certiorari denied, 311 U. S. 693; *18th Street Leader Stores* v. *United States*, 142 F. 2d 113, 115-116 (C. A. 7th), certiorari denied, 323 U. S. 725; cf. *United States* v. *Garbutt Oil Co.*, 302 U. S. 528, 535.

2. The Court of Appeals properly denied (R. 293) taxpayer's claims for additional deductions for repairs for 1924-1928, inclusive (Br. 55-58),

and for additional deductions for South Carolina taxes for 1926-1928 (Br. 58-59). The complaint did not claim such deductions for either item for the years 1927 and 1928 (R. 36-51), and up to the date the District Court entered its final findings of fact, conclusions of law and judgment (R. 156-159, 279-286) the taxpayer does not appear to have raised issues as to such deductions for 1927 and 1928 or as to South Carolina taxes for 1926 (see statement of questions raised at R. 279-280). The claimed additional deductions for repairs for 1927-1928 and South Carolina taxes for 1926-1928 were therefore not properly before the Court of Appeals. The District Court allowed deduction in 1926 of the $9,531.81 now claimed for repairs in that year (R. 157). It had no jurisdiction under Section 3226 of the Revised Statutes to allow additional deductions for repairs in 1924 and 1925 or for South Carolina taxes in 1926, since the taxpayer's original claims for refund presenting these claims were rejected more than two years before the suit was filed. (R. 146-148.) Moreover, there are no findings to support conclusions on the merits (1) that the so-called repairs in 1924 and 1925 were actually incidental repairs, rather than, as the Commissioner determined (R. 255-256), replacements which are depreciable capital items and not deductible (Article 104, Treasury Regulations 65 and 69, Appendix, *infra*, p. 14); or (2) that the South Carolina taxes accrued in 1926-1928 so as to be deductible in those years.

3. The Court of Appeals correctly denied (R. 293) taxpayer's apparent claim (Br. 59-62) for deductions in 1923, 1924, and 1925, in the amounts by which the face value of its accounts receivable exceeded their cost or market value, whichever was lower. The taxpayer properly used in those years the accrual accounting method of reporting the face value of accounts receivable as accrued income and deducting therefrom as bad debts under Section 234 (a)(5), Revenue Acts of 1921 and 1924 (Appendix, *infra*, pp. 9-11) such parts of the receivables as were ascertained to be worthless and charged off. (R. 136.) It is not entitled to exclude or deduct from accrued income the excess of the face amount of the accounts receivable over their cost or market value (*Spring City Co.* v. *Commissioner*, 292 U. S. 182, 184-185, rehearing denied, 292 U. S. 613; *Charles C. Lewis Co.* v. *United States*, 14 F. Supp. 471, 473-474 (D. Mass.)) particularly when such deductions would in effect duplicate the bad debt deductions provided for in Sec. 234(a)(5), and under which taxpayer was allowed deductions (R. 136). Moreover, the claims for refund based on this ground, which were filed June 27, 1931 (R. 147), were not timely as to the taxes paid under the original assessments for 1923-1925 under Section 284 (b) (1), Revenue Act of 1926 (Appendix, *infra*, p. 12) and therefore would not permit recovery, except as to the unrefunded deficiencies in tax for these years paid in 1928 and 1929 (R. 146-148).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
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ELLIS N. SLACK,
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Special Assistants to the Attorney General.

MAY, 1950.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227:

SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * *

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * *

(5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;

* * * * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

* * * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253:

SEC. 203. * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means * * * (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or * * * (D) a mere change in identity, form, or place of organization, however effected.

* * * * * *

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * *

(7) If the property (other than stock or securities in a corporation a party to the reorganization) was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law appli-

cable to the year in which the transfer was made;

* * * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

(c) The basis upon which * * * exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, * * *.

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

* * * * * *

Section 234 (a) (5) of the Revenue Act of 1924 is the same as the corresponding section of the Revenue Act of 1921, above quoted.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 284. (a) Where there has been an overpayment of any income * * * tax imposed by this Act, * * * the Revenue Act of 1921, or the Revenue Act of 1924, * * * the amount of such overpayment shall, * * * be credited against any income, tax * * * then due * * *, and any balance of such excess shall be refunded immediately to the taxpayer.

(b) Except as provided in * * * [exceptions not material] * * *

(1) No such credit or refund shall be allowed or made after three years from the time the tax was paid in the case of a tax imposed by this Act, nor after four years from the time the tax was paid in the case of a tax imposed by any prior Act, unless before the expiration of such period a claim therefor is filed by the taxpayer; * * *

* * * * * *

SEC. 1113. (a) Section 3226 of the Revised Statutes, as amended, is reenacted without change, as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, * * * until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pur-

suance thereof; * * * No such suit or proceeding shall be begun * * * after the expiration of five years from the date of the payment of such tax, * * * unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail."

Sections 203 (h) (1), 204 (a) (7), (b) and (c), and 234 (a) (1) and (7) of the Revenue Act of 1926, are the same as the corresponding sections of the Revenue Act of 1924, above quoted.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(k) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

* * * * *

(m) *Basis for depreciation and depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

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Sections 112 (i) (1), 113 (a) (7) and (b), and 114 (a) of the Revenue Act of 1928 are the same as

Sections 203 (h) (1) and 204 (a) (7), (b) and (c) of the Revenue Act of 1924, above quoted.

Treasury Regulations 65, promulgated under the Revenue Act of 1924:

> ART. 104. *Repairs.*—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept. * * *

Article 104 of Treasury Regulations 69, promulgated under the Revenue Act of 1926, is the same as Article 104 of Regulations 65, above quoted.

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